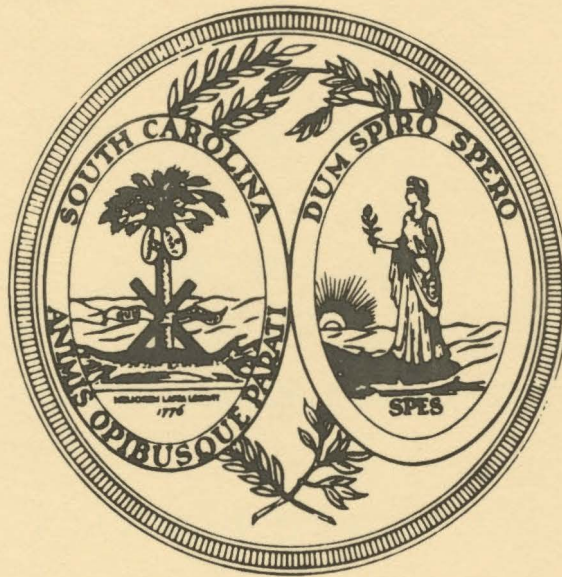


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The State of South Carolina
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A Review of the South Carolina
State Ports Authority's
Grain Elevator
At Charleston

THE STATE OF SOUTH CAROLINA

GENERAL ASSEMBLY

LEGISLATIVE AUDIT COUNCIL

A REVIEW OF THE SOUTH CAROLINA

STATE PORTS AUTHORITY'S GRAIN ELEVATOR

AT CHARLESTON

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REPORT SUMMARY

Introduction

The Legislative Audit Council was requested by the General Assembly to conduct an audit of the grain elevator lease arrangement between the South Carolina State Ports Authority and the South Carolina Farm Bureau Marketing Association. The audit addressed the specific questions raised in the audit request.

In conducting this audit, the Council examined areas of concern relating to compliance with applicable laws and general management of the grain elevator. The Council reviewed pertinent State laws and all Management Agreements between the Ports Authority and the Farm Bureau Marketing Association. Prior audit reports of the Ports Authority and the Marketing Association's operations of the grain elevator were examined. Other statewide information was utilized to develop an understanding of the grain elevator's impact on the farmers and the economy of the State. The information contained in this report is based primarily on the facts available through cooperating State agencies. The Council requested assistance from the Farm Bureau Marketing Association. However, the Marketing Association's attorneys stated that the records of the Farm Bureau Marketing Association were confidential and not available to the Council.

The body of the report is divided into a summary and three chapters. Chapter I contains a background and history of the grain elevator lease arrangement between the Ports Authority and the Farm Bureau Marketing Association. Chapter II concerns the Ports Authority's management of

the grain elevator and Chapter III addresses issues related to the operation of the grain elevator. This report summary lists the specific questions contained in the audit request and the Council's findings related to those questions.

Questions Requested to be Answered by the General Assembly

Question 1: Why does the South Carolina Ports Authority lease the State's facility to the South Carolina Farm Bureau [Marketing Association] and in turn, they sublease it to a Georgia corporation? Is the Farm Bureau a necessary party?

Act 1272 of 1970 and a House Resolution dated June 22, 1971 both express the intent of the Legislature to give the Farm Bureau Marketing Association priority in the contractual arrangement. The Farm Bureau Marketing Association, in turn, made an agreement with Cargill, Inc., a large grain company based in Minneapolis, Minnesota, to store and handle grain for Cargill. However, the Marketing Association does not sublease the elevator to Cargill, Inc. At the time the agreement was made the Farm Bureau Marketing Association, a private corporation, was near bankruptcy. The effect of the agreement was to allow the Farm Bureau Marketing Association to repay its loans at a five to six percent rate of return, while stockholders were paid face value for their stock. By FY 73-74, the Farm Bureau Marketing Association had repaid its debts primarily through profits made from the grain elevator operation. For the period FY 73-74 through FY 79-80, the Farm Bureau Marketing Association has generated a net profit of \$3.8 million from the Charleston grain elevator.

According to a 1971 study made by Clemson University, what is necessary for the successful operation of the grain elevator is a large grain company with international ties to effectively participate in the export markets. The Clemson study recommended that "...the lessor should strongly favor bids by firms whose primary interest and activity is exporting..." The study further stated that bids from export firms already operating other facilities should be "...favored somewhat because of their greater potential for more stable operating procedures..." Cargill, Inc. is such an international exporter, and in 1971 submitted an independent bid to operate the grain elevator. Based on these facts the Council concludes that the Ports Authority could have contracted directly with a firm such as Cargill, Inc., and that the Farm Bureau Marketing Association was not and is not a necessary party to successfully operate the grain elevator.

Question 2: Are, and have, the taxpayers of South Carolina subsidized the South Carolina Farm Bureau [Marketing Association]? If so, to what degree and what are the legalities of this arrangement?

The Council found that the State has subsidized the operation of the grain elevator to the extent of \$2,506,865 for the period 1957-1980.

In order to determine the legalities of the agreement between the Ports Authority and the Farm Bureau Marketing Association, the Council requested an opinion from the State Attorney General. The opinion issued on June 15, 1981 states:

...it is the opinion of this Office that the agreement between the Authority and the Association appears not to be valid because this arrangement seems to

require a yearly expenditure of State funds to subsidize the operation of an enterprise upon which a private corporation is making a profit.

Question 3: Are South Carolina farmers losing as a result of the present use of this facility?

The Council compared soybean prices offered at the Charleston grain elevator with prices offered at the Savannah, Georgia grain export elevator and found that prices offered at Savannah were slightly higher than prices offered at Charleston in 1979 and 1980. An official of the South Carolina Department of Agriculture stated that the difference was not significant.

The Council also compared per-bushel soybean prices offered to farmers at the Charleston grain elevator with prices offered at five other elevators around the State to determine if farmers are receiving lower prices for soybeans at the Charleston elevator. The analysis indicates that prices offered for soybeans at the Charleston elevator have been higher than prices offered for soybeans at other grain elevators in the State. These higher prices are primarily attributable to the use of the Charleston grain elevator as an export facility, and not to the operation of the facility by the Farm Bureau Marketing Association.

Question 4: Is this arrangement limiting shipment of South Carolina grains from the Charleston Port? Might it not be advantageous to the farmers of this State if they were to have priority use of this facility over other sister states?

The agreement with Cargill, Inc., made by the Farm Bureau Marketing Association, restricted the use of the grain elevator to Cargill, Inc., for three years - from August 1, 1977 to July 31, 1980. The agreement

required the Farm Bureau Marketing Association to keep all grain storage space in the elevator available for the exclusive use of Cargill, Inc.

The Farm Bureau Marketing Association agreed to store and handle all grain for Cargill, Inc., coming into and going out of the grain elevator, and was expected to make grain sales to Cargill, Inc.

Some grain is obtained from adjacent states; however, the Ports Authority could not provide comparative information of South Carolina farmers' use of the elevator to out-of-state use. Therefore, it could not be determined whether South Carolina farmers receive priority use of the grain elevator.

Question 5: Are South Carolina taxpayers and farmers reaping the maximum benefit from the present use of this facility?

In FY 79-80, a total of 391,706 tons of soybeans, wheat and corn passed through the grain elevator. The cost of grain sales to the FBMA during this same year was \$94.3 million. The grain farmers of the State are the primary benefactors of the elevator. However, the grain crops that benefit as a result of the elevator are small in comparison to the total cash receipts of all of South Carolina's commodities. Cash receipts from soybeans, corn, and wheat were \$283 million in 1980, which represents grain traded intrastate, interstate and exported through the grain elevator. This was only 26.4% of the \$1.07 billion received for all of South Carolina's crops, livestock, and livestock products for that year.

The Council examined the financial position of the Ports Authority and the State on the grain elevator. The Ports Authority's Statements of Operations show a gross loss of \$1,816,178 on the grain elevator

from 1962 to 1980 (see Appendix A). Yet when the Council included the interest on bonds and all income received by the elevator, the gross loss was \$2,506,865 (see Appendix B). Gross loss figures were used rather than net loss because the actual overhead expenses of the Authority administering the contract were not available. This results in the costs of the State being slightly understated, since the administrative costs for the elevator were estimated to have been only \$18,328 for 1963-1980.

The Council also examined the net cash flow associated with the grain elevator, which shows the income received and actual funds expended on the elevator over a designated period of time and does not include non-cash items like depreciation expense. The cash flow analysis shows that from 1957-1980 the State made a net cash outlay of \$5,946,243 on the grain elevator. In contrast to this and the State's loss of \$2,506,865, CPA audits of the grain elevator show that the FBMA received a net income of \$3,841,625 from 1962-1980 (see Table 3).

The problem with the operation of the grain elevator is that the State is not covering all of the costs associated with the elevator and is not benefiting from the profits of this facility. The situation could be corrected by increasing the annual rental fee paid by the Farm Bureau Marketing Association to the Ports Authority for leasing the grain elevator. However, this remedy is hampered by the 21-year Management Agreement between the Ports Authority and the Farm Bureau Marketing Association. Under this agreement an annual fixed rent of \$77,352 is to be paid to the Ports Authority for the duration of the agreement and the State has no option to change the annual rental fee until 1998.

Major Finding - Constitutionality of Management Agreement Between
Ports Authority and Farm Bureau Marketing Association Questionable

The Council found that the grain elevator lease arrangement between the Ports Authority and the Farm Bureau Marketing Association (FBMA) does not recover all of the State's costs for the operation of the grain elevator. Because of the low rental fee paid by the FBMA to the Ports Authority, the State has incurred a net loss on the grain elevator of \$2.5 million from 1962 through 1980. During this same time period, the FBMA made profits totaling \$3.8 million from the operation of the grain elevator in Charleston.

The loss to the State has occurred because the annual rental fee is insufficient to cover the interest payments on the bonds issued to construct the elevator. Interest payments are made from the State Treasury with State General Funds. Furthermore, a change in the depreciation method in 1977 placed the depreciation of the grain elevator and related equipment on a 71-year schedule, which is inconsistent with industry standards. The Council reviewed these standards with the director of the Clemson University Engineering Department and with the State Engineer of the Budget and Control Board. Both engineers stated that the expected life of a grain elevator is 40-50 years. Increasing the number of years the structures and equipment were to be depreciated reduced the Ports Authority's depreciation cost per year. Since the rent payment was based on a concept of covering depreciation costs and insurance, this reduced the amount of rent the FBMA would be charged each year.

The failure to recover all costs for the operation of the grain elevator, while the FBMA is making a profit, makes the constitutionality

of the current Management Agreement between the Ports Authority and the Association questionable. Article 10, Section 11 of the Constitution of South Carolina prohibits the pledging of the credit of the State or the use of funds raised by taxation for the benefit of a private corporation.

On June 15, 1981, the Attorney General issued an opinion on the Management Agreement which states:

...it is the opinion of this Office that the agreement between the Authority and the Association appears not to be valid because this arrangement seems to require a yearly expenditure of State funds to subsidize the operation of an enterprise upon which a private corporation is making a profit. Therefore, the agreement does not constitute a legal contract...

A similar case involving the use of general obligation bonds to benefit a private corporation, even though there may be incidental benefit to the public, was brought before the South Carolina Supreme Court. The South Carolina Supreme Court decision in the case of McLeod v. Riley, et al., 276 S.C. 323, 278 S.E. 2d 612 (1981), addresses the financing of an alcohol fuel development loan program. Based on the provisions of Article 10, Section 11 of the Constitution of South Carolina, the Supreme Court, citing earlier cases, states:

...The incidental advantage to the public or to the State, which results from the promotion of private interests, and the prosperity of private enterprises or business, does not justify their aid by the use of public money raised by taxation, or for which taxation may become necessary.

By not including interest payment costs in the annual rental fee and extending the depreciation schedule on the elevator structures and equipment, the Ports Authority reduced the rental fee that the FBMA would have to pay to cover all costs to the State. In effect, this

resulted in the State subsidizing the FBMA to the extent of \$2.5 million and the Ports Authority making a major policy decision without legislative approval.

Related to this issue is the question of whether or not the Farm Bureau Marketing Association is a necessary party to operate the grain elevator. The Council concluded that the Marketing Association is not a necessary party to successfully operate the grain export elevator. The State Ports Authority could perform the same functions being performed by the FBMA at the grain elevator. What is necessary for the successful operation of the grain elevator as an export facility is a large grain company with international ties to effectively participate in the international markets. The Marketing Association has contracted with a large grain company, Cargill, Inc., which is an international exporter.

Ports Authority officials felt it was the intent of the Legislature that the FBMA be given preferential treatment in the operation of the grain elevator. Act 1272 of 1970 and a House Resolution passed on June 22, 1971, indicate that legislative intent was to give the FBMA priority in the operation of the grain elevator (see Appendices E and F). These legislative actions were taken at a time when the FBMA had suffered heavy operating losses on the grain elevator, declared it was bankrupt and had been placed in receivership. These legislative steps appeared to be an attempt to make it possible for the FBMA to continue operation of the grain elevator. However, neither Act 1272, nor the House Resolution stated that the grain elevator should be leased for a rental fee that failed to cover all costs to the State. As a result of the 1971 Management Agreement which began a State subsidy, the FBMA was able to repay its loans and began making a profit in FY 73-74 (see p. 19).

Noncompliance with State Law

The Ports Authority has not complied with all requirements of Act 1272 of 1970 to review and report on operations of the grain elevator. The Ports Authority did not request or receive annual audits of the grain elevator conducted by independent auditors and did not approve the certified public accountants chosen by the Marketing Association to conduct the audits. The Ports Authority has not adequately reviewed the operation and status of the grain elevator to determine if the elevator is operated in an efficient and effective manner and has not submitted annual reports on the elevator operation to the Budget and Control Board and the General Assembly. Consequently, the Ports Authority has not ensured that the grain elevator has been operated in the best interest of the State and its farmers and the Ports Authority's accountability to the public and the Legislature is limited (see p. 35).

Lack of Annual Inspections of the Grain Elevator

The Ports Authority has not conducted annual inspections of the facilities and equipment at the grain elevator, as required by the Management Agreement, since the agreement took effect in 1977. In the absence of formal inspections, the State cannot be assured that the Marketing Association is in compliance with the terms of the Management Agreement or that the elevator is structurally sound and safe for use (see p. 39).

Identifying and Approving Plans for Improvements Needed

The Council found the Ports Authority has no system for identifying and approving plans for improvements to the grain elevator which

the Marketing Association is required to make under the terms of the 1977 Management Agreement. A list compiled by the Ports Authority, showing improvements with a value of \$1.6 million, only identified the amount of money paid to vendors and did not adequately identify or describe any improvements or equipment purchases for the elevator. Consequently, the Council could not verify what improvements were made to the grain elevator, and the Ports Authority has not ensured that improvements were made as required. In addition, no plans for improvements had been approved in writing by the Ports Authority as required by the Management Agreement (see p. 41).

Conclusion

The Council concludes that the Management Agreement between the Ports Authority and the FBMA is constitutionally suspect because the State has not covered all costs for the operation of the grain elevator, which has been to the benefit of the FBMA. Because the Ports Authority has not covered all costs to the State for the grain elevator, the State has subsidized the FBMA to the extent of \$2.5 million. This action has resulted in the Ports Authority making a major policy decision without legislative approval. The Council also concludes that the need for improved State oversight in the operation of the grain elevator is of major importance.

The use of public funds carries with it explicit and implicit responsibilities to use such funds as mandated, to comply with laws regarding their use and to provide complete and accurate information on the benefits derived. It is to this end that the following summary of recommendations is directed.

RECOMMENDATIONS

- (1) THE ATTORNEY GENERAL SHOULD INITIATE
LEGAL ACTION TO DETERMINE IF THE
MANAGEMENT AGREEMENT BETWEEN THE PORTS
AUTHORITY AND THE FARM BUREAU MARKETING
ASSOCIATION IS CONSTITUTIONAL.

THE PORTS AUTHORITY SHOULD PLACE THE
OPERATION OF THE GRAIN ELEVATOR ON A
SOUND FINANCIAL BASIS AND RECOUP ALL
LOSSES THE STATE HAS INCURRED. THE PORTS
AUTHORITY SHOULD NEGOTIATE A NEW
MANAGEMENT AGREEMENT FOR THE FUTURE
OPERATION OF THE ELEVATOR THAT PROVIDES
FOR A RENTAL FEE WHICH COVERS ALL COSTS
TO THE STATE, BASED ON A REASONABLE
DEPRECIATION SCHEDULE.

- (2) SECTION 8 OF ACT 1272 OF 1970 REQUIRES THAT
AT THE END OF EACH FISCAL YEAR THE PORTS
AUTHORITY SHALL REVIEW THE ENTIRE OPERA-
TION OF THE GRAIN ELEVATOR, APPROVE A
CERTIFIED PUBLIC ACCOUNTANT SELECTED BY
THE FARM BUREAU MARKETING ASSOCIATION TO
CONDUCT A COMPLETE AUDIT, AND SUBMIT A
REPORT TO THE BUDGET AND CONTROL BOARD
AND THE GENERAL ASSEMBLY ON THE OPERATION

OF THE ELEVATOR. TO CONFORM WITH THE PROVISIONS OF THIS ACT, THE PORTS AUTHORITY SHOULD:

- (a) REQUEST THE ASSISTANCE OF THE STATE AUDITOR AND EXERCISE ITS APPROVAL RESPONSIBILITY FOR CERTIFIED PUBLIC ACCOUNTANTS SELECTED BY THE FARM BUREAU MARKETING ASSOCIATION FOR ANNUAL AUDITS,
 - (b) CONDUCT AN ANNUAL REVIEW OF THE . OPERATION OF THE ELEVATOR TO INCLUDE AN EXAMINATION OF THE FINANCIAL AUDIT, ON-SITE INSPECTIONS AND INTERVIEWS WITH MANAGEMENT, AND
 - (c) SUBMIT ANNUAL REPORTS TO THE BUDGET AND CONTROL BOARD AND THE GENERAL ASSEMBLY, BASED ON ITS REVIEW.
- (3) THE PORTS AUTHORITY SHOULD DEVELOP CRITERIA FOR ANNUAL JOINT INSPECTIONS OF THE FACILITIES AND EQUIPMENT AT THE GRAIN ELEVATOR.

THESE INSPECTIONS SHOULD BE CONDUCTED BY A PROFESSIONAL ENGINEER FROM THE MANAGEMENT SERVICES DIVISION OF THE PORTS AUTHORITY, AND REPRESENTATIVES OF THE FARM BUREAU

MARKETING ASSOCIATION IN ACCORDANCE WITH
THE CONDITIONS OF THE 1977 MANAGEMENT
AGREEMENT.

- (4) THE PORTS AUTHORITY SHOULD DEVELOP A
COMPLETE INVENTORY DESCRIPTION, LISTING
ALL IMPROVEMENTS MADE TO THE GRAIN ELEVATOR,
AND INCLUDE EQUIPMENT INFORMATION SUCH AS
MANUFACTURER'S NAME, TRADE NAME, SIZE,
COLOR AND SERIAL NUMBER. ALL EQUIPMENT
SHOULD BE INDIVIDUALLY TAGGED AS "PROPERTY
OF THE SOUTH CAROLINA STATE PORTS AUTHORITY."
FACILITY IMPROVEMENTS INCLUDING FIXED
EQUIPMENT SHOULD BE COMPLETELY DESCRIBED,
APPRAISED, AND INCLUDED ON THE INVENTORY.

THE PORTS AUTHORITY SHOULD GIVE PRIOR
WRITTEN APPROVAL FOR ANY IMPROVEMENTS OR
ALTERATIONS MADE TO THE GRAIN ELEVATOR.

CHAPTER I
BACKGROUND AND HISTORY

The South Carolina State Ports Authority was created in 1942 by the General Assembly to engage in promoting, developing, constructing, equipping, maintaining, and operating the harbours within the State. The Ports Authority owns and operates three seaports and one inland port which handle the import and export of various cargo. The grain elevator is only one of a number of facilities owned by the Ports Authority. The Ports Authority's total assets for FY 79-80 were \$104,237,204; the grain elevator accounted for approximately 3% of these assets.

The Ports Authority operates as a self-supporting governmental enterprise and does not receive an annual state appropriation to meet operating expenses. The Ports Authority ended FY 79-80 with operating revenues of \$23,381,683, an increase of 5% over the previous year. Net income in FY 79-80 amounted to \$4,937,025, an increase of 12.1% over FY 78-79. Furthermore, economists estimate that the ports industry and port-related manufacturing generate more than 42,000 jobs throughout the State. This, plus recent fiscal year statistics, appear to indicate a marked growth trend of South Carolina's ports under the management of the Ports Authority and the importance of the ports industry to the economy of the State.

In 1956 the General Assembly authorized the issuance of \$2,092,877 in general obligation bonds to enable the South Carolina State Ports Authority to construct adequate facilities for exporting soybeans and other small grains from one of its ports. In 1960, a public hearing was held in Charleston to obtain the views of all interested parties on the

feasibility and practical aspects of exporting soybeans from South Carolina. Shortly thereafter, construction began on the grain elevator and silos, and the 640,000 bushel grain export facility was completed in 1962.

The South Carolina Farm Bureau Marketing Association (FBMA) was incorporated as a non-profit cooperative association in December 1961, under the provisions of the Cooperative Marketing Act of 1952, as amended. All stock issued is owned by the South Carolina Farm Bureau. The FBMA was organized to engage in cooperative activity for the benefit of its members or patrons in connection with the production, marketing and selling of agricultural products.

In August 1962, the Ports Authority entered into its first Management Agreement with the FBMA for the lease of the grain elevator. The agreement provided for the elevator to be leased to and operated by the FBMA for which the Ports Authority would receive one-half of the net profits from the operation as a rental fee. The Association began operation of the elevator on October 4, 1962.

In Act 486 of 1965, the General Assembly authorized the issuance of \$2.5 million in general obligation bonds to expand the grain elevator to store 1.6 million bushels of grain. Act 486 required the Ports Authority to collect a per-bushel charge from the users of the elevator in order to provide for the payment of the principal and interest on bonds issued to expand the elevator. The fees collected would be remitted to the State Treasurer. The Ports Authority and FBMA entered into a new Management Agreement in October 1965 to provide for the FBMA to lease the grain elevator and expansion facilities when completed and to collect the per-bushel fee for the use of the elevator. The Ports

Authority would receive a share of the profits from the operation of the elevator as a rental fee.

During 1969-70 the FBMA suffered heavy financial losses. In July 1970, the Budget and Control Board reviewed the financial problems of the Marketing Association with respect to its future operation of the elevator. The Board unanimously agreed that the Ports Authority's contract with the FBMA should be extended through June 30, 1971, but modified so that the Authority would assume responsibility for insurance and maintenance costs. The Board also requested Clemson University to conduct a study with the University of South Carolina to determine the most desirable plan for the future operation of the elevator.

In August 1970, the Ports Authority modified its Management Agreement with the FBMA as directed by the Budget and Control Board. The modification also eliminated the per-bushel fee for the use of the grain elevator since the General Assembly eliminated the fee in Act 1272 of 1970.

In April 1971 Clemson University released a report entitled "An Economic Analysis of Current and Future Operations of the Charleston Elevator," as requested by the Budget and Control Board. The report recommended that the Ports Authority strongly favor bids for the operation of the elevator from firms whose primary activity was exporting grains. The report further suggested that the lease should be based on fixed sum payments, instead of a share of the profits from operation or a per-bushel fee.

In June 1971 the Ports Authority invited proposals for the operation of the elevator from grain companies, as recommended in the Clemson report. On June 22, 1971, a House Resolution was passed which requested

the Ports Authority to extend its contract with the Marketing Association for one year until June 30, 1972. However, a resolution does not have the force of law. Following the passage of the House Resolution, the Ports Authority requested the FBMA to submit a proposal to continue operation of the grain elevator.

The Ports Authority received bids from the FBMA and Cargill, Incorporated. The bid from the FBMA stated that it would operate the grain elevator under an arrangement with a large grain export company, Cargill, Inc. The members of the Ports Authority accepted the bid from the Association and executed a new Management Agreement in September 1971. The new agreement set an annual rental fee of \$25,000 and required the FBMA to maintain elevator equipment.

In October 1971 the FBMA declared that it was unable to pay its debts due to heavy operating losses in 1969-70 and filed a petition in the United States District Court to put into effect a plan for reorganization. The plan was approved by the Court in July 1972. The FBMA continued operating the elevator during this time. In 1976 the Court declared that the provisions of the plan for reorganization had been fulfilled and the FBMA had discharged all debts against it.

In 1977 the Ports Authority and the Marketing Association entered into the Management Agreement now in effect. The Ports Authority leased the grain elevator for an annual fee of \$60,500. In May 1980, the agreement was modified to allow the FBMA to lease a 3.6 acre tract of land adjacent to the grain elevator and raised the annual rental fee to \$77,352 to cover the lease of the additional land.

CHAPTER II
PORTS AUTHORITY MANAGEMENT

Constitutionality of Management Agreement Questionable

Introduction

In the request to conduct an audit of the grain elevator lease arrangement between the State Ports Authority and the South Carolina Farm Bureau Marketing Association (FBMA), the Council was asked to determine if the State's taxpayers are subsidizing the FBMA as a result of the lease arrangement and if so, to determine the legality of the arrangement. Further, the Council was requested to determine if the Marketing Association is making a profit from the operation of the grain elevator. The Council examined financial records of the Ports Authority, CPA audits of the FBMA, and the conditions of the lease agreement in order to answer the questions raised in the audit request. The Council requested an opinion from the Attorney General's Office to determine the legality of the Management Agreement.

The Council found that the FBMA has been given preferential treatment by the Ports Authority as the lessee of the grain elevator. The Ports Authority has not considered all costs, such as interest payments on bonds issued to construct the elevator, in determining the fixed annual rent to be paid by the Association. In addition, the annual rent was increased from \$25,000 to \$60,500 in 1977 to cover insurance costs and a reasonable allowance for depreciation. At the same time, the Ports Authority changed the depreciation schedule to reduce the yearly amount from approximately \$153,000 per year to \$51,000 per year. This procedure, which is inconsistent with industry standards, has the effect of lowering the rental payment. This resulted

in a rental fee of approximately \$102,000 less than it should have been to cover a reasonable allowance for depreciation. Finally, the 1977 Management Agreement does not give the State any option to change the terms under which the Marketing Association may lease the grain elevator for the next 21 years. However, the lease may be extended at the option of the FBMA. As a result, the State has lost \$2.5 million on the grain elevator from 1957-1980. Furthermore, the Attorney General issued an opinion on the Management Agreement on June 15, 1981, which states that the Management Agreement appears to be constitutionally suspect because the Agreement has caused a net loss to the State while providing the FBMA with a profit.

Lease Payment Does Not Cover All Costs

The annual rent paid by the FBMA for leasing the grain elevator covers the Ports Authority's annual insurance and depreciation costs for the elevator structure and equipment. However, the rent does not cover the annual interest payments on bonds issued to construct the elevator.

The Ports Authority has not considered interest payments as a cost to be covered in the annual rent because the interest is paid from the State Treasury and is not a direct cost to the Ports Authority. Sound business practices would require that all costs be considered in determining the appropriate amount of rent for a lease arrangement and to provide for a return on investment. The exclusion of interest costs from the rent amount results in the State's losing money. For example, interest payments on bonds for 1979-80, for which the State Treasury was not reimbursed, totaled \$30,880.

Depreciation Expense Rescheduled

During FY 77-78 the Ports Authority changed the depreciation schedule for the grain elevator by combining the expense categories of equipment and structures, and depreciating the total amount over an extended period of 71 years. Prior to the change in the depreciation schedule in FY 77-78, the Ports Authority depreciated the grain elevator structures over a period of 50 years and equipment over 20-25 years.

This action reduced the yearly amount for depreciation from \$162,770 in FY 76-77 to \$51,000 in FY 77-78. The change was made when the new Management Agreement became effective in 1977 and increased the annual rent from \$25,000 to \$60,500 to cover insurance on the grain elevator and a reasonable allowance for depreciation.

According to Ports Authority officials, the decision to use 71 years was based on new obligations of the FBMA in the 1977 Management Agreement. A memorandum dated August 7, 1980 from the Controller to the Director of Finance of the Ports Authority stated:

As you and I have discussed recently (and originally discussed in 1977), the basis for the decision to use 71 years is to be found in the significant new obligations of the South Carolina Farm Bureau Marketing Association in the March 1, 1977 Management Agreement. Those new obligations consist of: (1) the Association bearing the total cost of repairs and maintenance; (2) the Association expending approximately \$2 million to improve the capabilities and through-put capacity of the elevator; and (3) the Association also making throughout the term such improvements and adaptations as are necessary to keep the equipment suitable for use in the then current trade of handling, lading, discharging, and storing grain. Those new obligations meant that the Authority, after the 21 years of the Agreement, would have a technologically sound elevator in good repair, such that the then remaining unamortized cost would reasonably be written-off over the next 50 years. Please recall that we researched this rescheduling in accounting literature and discussed it with our independent auditors, who accepted our concepts.

Increasing the number of years the structures and equipment were to be depreciated reduced the Ports Authority's depreciation cost per year. Since the rent payment was based on a concept of covering depreciation costs and insurance, this procedure reduced the amount of rent the FBMA would be charged each year. For example, the Ports Authority should have charged approximately \$102,000 more rent in 1979-80 to cover depreciation expenses (see Table 2). Furthermore, depreciating equipment with structures over a 71-year period grossly overstates the useful life of such equipment.

The Ports Authority has stated that the bulk of the original elevator equipment, purchased in 1962-63, needed to be either replaced or improved in 1977, indicating it had a useful life of approximately 15 years. Under its depreciation schedule prior to 1977, the Ports Authority depreciated the original elevator equipment over 20 years and equipment purchased in 1967 over 25 years. If the depreciation schedule had not been changed in 1977, the original equipment would have been fully depreciated on the Ports Authority's financial statements in 1982 and equipment added in 1967 would have been fully depreciated in 1992. The book value of all elevator equipment in 1977 was \$523,907. At this time, the Ports Authority began depreciating the remaining value of the equipment over 71 years, which reduced the losses to the State from \$164,452 in FY 77-78 to \$62,467. Furthermore, the 71-year depreciation schedule on the remaining value of equipment is unreasonable since the bulk of equipment, as determined by the Ports Authority, had a useful life of only 15 years.

Depreciation is used as a basis for allocating the initial cost of a facility over the years of its useful life. Other large companies that

own grain elevators depreciate them over shorter periods of time. Cargill, Inc. depreciates its grain elevators over periods from 25-50 years, depending upon the type of structure. Continental Grain Company depreciates its grain elevators over periods from 30-40 years. Both companies depreciate equipment separately from elevator structures. Furthermore, the FBMA depreciates its grain elevators at a rate of $3\frac{1}{2}\%$ per year. This means that the FBMA depreciates its elevators over approximately 28 years.

Officials at Clemson University believe that 50 years would be the appropriate time period for depreciating the grain elevator. A 1970 study by the Department of Agricultural Economics at Clemson University stated that 50 years would be consistent with the expected economic life of the elevator structure, but used 45 years for amortizing all fixed costs which included structures and equipment. The Council contacted the Department Director of Civil Engineering at Clemson who stated that 50 years would be a reasonable expected life for the grain elevator. In addition, the State Engineer told Council staff that even with \$2 million of improvements to buildings and equipment, the elevator would probably be unusable before the end of 71 years. Parts of the elevator, completed in 1962, were already 15 years old when the depreciation schedule was changed in 1977. This means that parts of the elevator will be 86 years old at the end of the 71-year depreciation schedule. Such an unusual change in the method of accounting for depreciation is questionable when compared to standard practices as discussed above.

TABLE 1
DEPRECIATION SCHEDULES FOR GRAIN ELEVATORS AND EQUIPMENT

Organization	Length of Depreciation Schedule in Years	
	Grain Elevators	Elevator Equipment
Cargill, Inc.	25-50	15
Continental Grain Company	30-40	12.5
Farm Bureau Marketing Association	28.6	2-20
Ports Authority	71	71

No Option for the State

The 1977 Management Agreement between the Ports Authority and the FBMA does not give the State any options to change the conditions under which the Association leases the grain elevator for 21 years.

However, the FBMA is given an option as stated in the following:

...If the Association (FBMA) faithfully performs the agreements and covenants hereinafter set out, the Association shall have the option to renew or extend this lease on the same terms and conditions for an additional fifteen (15) years immediately following the initial term... [Emphasis Added]

Furthermore, the annual fixed rent of \$77,352* set forth in the Management Agreement, as amended, shall be paid to the Ports Authority

*The 1977 Management Agreement was amended in May 1980 to allow the FBMA to lease an additional 3.6-acre tract adjacent to the grain elevator and increase the annual rent to \$77,352 to cover the lease of the additional land. The conditions under which the elevator and land are leased were not changed.

during the initial six-year term and any succeeding option period which the Association may exercise. In addition, the lessee would have to pay only 6% per annum interest on all payments more than 30 days late.

The Ports Authority has negotiated a Management Agreement which does not allow changes to be made as economic and operational conditions have changed. The Division of General Services, which approves the lease of State property for the Budget and Control Board, generally requires that leases of State-owned property give the lessee the option to renew the lease, but at terms to be determined mutually by both parties when a new lease is negotiated. However, the Authority is not required to have its lease agreements approved by the Budget and Control Board.

As a result of the Ports Authority's preferential treatment of the FBMA, the State has subsidized the grain elevator since the elevator began operation in 1962. The Ports Authority received rental income of \$63,309 in 1979-80 for leasing the facility; however, a fee of \$194,511 should have been charged to cover all costs. A 1971 Clemson University study of the grain elevator calculated that \$223,686 per year for 45 years should be returned to the State to reimburse it for the elevator investment. In addition, the Ports Authority generally receives a 13% rate of return on improvements to its facilities and 10% on land. However, the Ports Authority has not included a rate of return on the State's investment in the grain elevator in figuring the rental fee, except on a 3.6-acre tract of land leased to the FBMA in May 1980.

For the State to break even for the first six years of the 1977 Management Agreement, the FBMA should have been charged an average

rental fee of \$191,896 per year. This fee is based upon a depreciation schedule not exceeding 50 years (see Table 2). However, this would not compensate the State for any losses incurred prior to the 1977 Agreement. The amount required to cover all costs of the elevator decreases each year. For instance, in FY 77-78 the total cost was \$224,952 but should decrease to \$133,994 for FY 82-83. By FY 97-98 the costs that need to be recovered would only be \$84,596 per year. This decrease over time is due to various items of equipment being fully depreciated, and the State Treasurer completing the interest payments on bonds.

The grain elevator could be operated on a break-even basis if the rental fee charged by the Ports Authority is increased. The FBMA could pay for the increase by lowering its profits without decreasing the price paid to farmers for grain. Profits have been sufficient to cover the costs necessary for the State to break even. Since the beginning of the Management Agreement in FY 77-78, profits have not been below \$236,728 and increased to \$571,460 for FY 80-81.

The Council examined the Ports Authority's Statements of Operations for the grain elevator, which were audited by certified public accountants, sources of income from the elevator, and records of interest on bonds for the grain elevator paid by the State Treasurer's Office. The Ports Authority's Statements of Operations show a gross loss of \$1,816,178 from 1962 to 1980 (see Appendix A). However, when the Council included the interest on bonds and all income received by the elevator, the gross loss was \$2,506,865 (see Table 3). Gross loss figures are used rather than net loss because the actual overhead expenses of the Authority for administering the contract are not available. This results

TABLE 2

ESTIMATED OPERATING EXPENSES TO THE STATE OF THE CHARLESTON GRAIN ELEVATOR

ASSUMING NO CHANGE IN THE ORIGINAL DEPRECIATION SCHEDULE

FY 77-78 TO FY 97-98

Fiscal Years	Insurance	Repairs and Maintenance		Depreciation Expense			Interest on Bonds	Total Expenses
		Property	Tracks	Assuming no Change in Original Depr. Schedule ¹	Sewage Pump and Water-loop Tie-in ²	Improvements to 3.6 acres ²		
77-78	\$ 9,451	\$19,363	\$244	\$ 152,985	\$ -	\$ -	\$ 152,985	\$ 42,909
78-79	9,708	4,522	-	152,985	3,799	-	156,784	36,045
79-80	6,782	-	-	152,985	3,864	-	156,849	30,880
80-81	7,000	-	-	152,985	3,864	8,063	164,912	25,714
81-82	7,000	-	-	152,985	3,864	8,063	164,912	21,321
82-83	7,000	-	-	98,067	3,864	8,063	109,994	17,000
83-84	7,500	-	-	98,067	3,864	8,063	109,994	12,750
84-85	7,500	-	-	98,067	3,864	839	102,770	8,500
85-86	7,500	-	-	98,067	3,864	839	102,770	4,250
86-87	7,500	-	-	98,067	-	839	98,906	-
87-88	7,500	-	-	96,734	-	839	97,573	-
88-89	7,500	-	-	96,734	-	839	97,573	-
89-90	7,500	-	-	96,734	-	839	97,573	-
90-91	7,500	-	-	96,734	-	839	97,573	-
91-92	7,500	-	-	96,734	-	839	97,573	-
92-93	7,500	-	-	76,833	-	839	77,672	-
93-94	7,500	-	-	76,833	-	839	77,672	-
94-95	7,500	-	-	76,833	-	839	77,672	-
95-96	7,500	-	-	76,257	-	839	77,096	-
96-97	7,500	-	-	76,257	-	839	77,096	-
97-98	7,500	-	-	76,257	-	839	77,096	-
TOTAL	\$159,441	\$23,885	\$244	\$2,198,200	\$30,847	\$43,998	\$2,273,045	\$199,369

¹This reflects the depreciation of the elevator prior to changing the depreciation to a basis of 71 years.²These improvements were incurred after the 1977 Management Agreement.

in the costs to the State being slightly understated, since the administrative costs for the elevator are estimated to have been only \$18,328 for 1963-1980.

The Council also examined the net cash flow associated with the grain elevator, which shows the income received and actual funds expended over a designated period of time and does not include non-cash items like depreciation expense. The cash flow analysis shows that from 1957-1980, the State made a net cash outlay of \$5,946,243 on the elevator (see Appendix C). In contrast to this and the State's loss of \$2,506,865, CPA audits of the grain elevator show that the FBMA received a net income totaling \$3,841,625 from 1962-1980 (see Tables 4 and 5).

The Council requested an opinion from the Attorney General to determine if the Management Agreement is a legal contract, based on the above figures. The opinion, issued on June 15, 1981, stated:

...the agreement appears to be constitutionally suspect because, according to facts provided by your staff, this agreement has caused a net loss to the State while providing a private corporation with a profit... It is the opinion of this office that the agreement between the Authority and the Association appears not to be valid because this arrangement seems to require a yearly expenditure of State funds to subsidize the operation of an enterprise upon which a private corporation is making a profit. Therefore, the agreement does not constitute a legal contract...

The Ports Authority has favored the Marketing Association as lessee of the grain elevator because management felt it was the intent of the General Assembly that the FBMA be given special priority in the operation of the elevator. Act 486 of 1965, and Act 1272 of 1970, provided that first priority in negotiating any new agreement or lease for the grain elevator be given to the current operator or lessee (FBMA)

upon the termination of the management agreement in effect at that time. Furthermore, a House Resolution, passed on June 22, 1971, requested the Ports Authority to extend its contract with the FBMA for one year. The management of the Ports Authority felt that these actions indicated that legislative intent was clear that the FBMA be given priority in the operation of the grain elevator.

Ports Authority officials also contend that the State will show a gross profit on the elevator by the end of the contract period in 1998. However, this will not occur based on the Ports Authority's projections. They consider expenditures by the FBMA for elevator maintenance and improvements to be benefits to the State. An opinion from the Attorney General stated that the Farm Bureau Marketing Association would be required to spend \$2 million for improvements under the present contract period (1977-83). An additional \$2 million would have to be spent if the Marketing Association elected to renew the contract for 15 years (1983-1998). However, improvements begin to depreciate in value from the time they are made. Consequently, the Ports Authority will not have \$4 million in improvements or benefits by 1998. The State Auditor, Edgar A. Vaughn, Jr., CPA, stated that equipment and improvements shown as a contractual benefit without showing the depreciation cost of such improvements to 1998 presents a distorted economic analysis of the grain elevator (see Appendix I).

The Ports Authority also considers the FBMA's assuming the cost of repairs and maintenance as a contractual benefit, which will contribute to a gross profit from the elevator by 1998. The State Auditor contends that the FBMA expending funds for repairs and maintenance should not be shown as a benefit to the State, because it presents a distorted

picture of the State's financial position on the elevator. While the Ports Authority is relieved of these expenditures, they also lose the reimbursement for these expenditures, normally covered as a portion of the rent. This presents a situation for the Ports Authority in which no economic gain is realized.

In summary, the Authority negotiated a contract with the FBMA for a lease amount that does not and will not cover all costs to the State. Furthermore, the contract does not give the State an option to change the lease terms for 21 years. These actions have resulted in a Management Agreement that in the opinion of the Attorney General is constitutionally suspect.

RECOMMENDATIONS

THE ATTORNEY GENERAL SHOULD INITIATE LEGAL ACTION TO DETERMINE IF THE MANAGEMENT AGREEMENT BETWEEN THE PORTS AUTHORITY AND THE FARM BUREAU MARKETING ASSOCIATION IS CONSTITUTIONAL.

THE PORTS AUTHORITY SHOULD PLACE THE OPERATION OF THE GRAIN ELEVATOR ON A SOUND FINANCIAL BASIS AND RECOUP ALL LOSSES THE STATE HAS INCURRED. THE PORTS AUTHORITY SHOULD NEGOTIATE A NEW MANAGEMENT AGREEMENT FOR THE FUTURE OPERATION OF THE ELEVATOR THAT PROVIDES FOR A RENTAL FEE THAT COVERS ALL COSTS TO THE STATE, BASED ON A REASONABLE DEPRECIATION SCHEDULE.

TABLE 3
STATEMENT OF REVENUES, EXPENSES AND GROSS INCOME
ON THE GRAIN ELEVATOR AT CHARLESTON FOR THE STATE
OF SOUTH CAROLINA, 1957-1980

	<u>Cumulative Totals 1957-1980</u>
Operating Revenues:	
Dockage Fee	\$ 297,424
Share of Profits	24,788
Per-Bushel Fee	595,303
Rental of Property	334,309
Miscellaneous	<u>167,742</u>
Total Revenue	<u>1,419,566</u>
Operating Expenses:	
Insurance	99,825
Outside Services	1,371
Repairs and Maintenance-Property	153,316
Repairs and Maintenance-Tracks	46,532
Depreciation	<u>2,171,656</u>
Total Operating Expenses	<u>2,472,700</u>
Operating Income	<u>(1,053,134)</u>
Nonoperating Expenses:	
Interest	<u>1,453,731</u>
Gross Profit (Loss) ¹	<u><u>\$(2,506,865)</u></u>

Note: ¹Gross profit and loss figures are depicted because administrative costs are not prorated by the Ports Authority in order that the net profit or loss may be determined. Ports Authority officials estimate administrative costs to be \$18,328 for 1962-1980.

Source: State Ports Authority Statements of Operations 1962-1980 and State Treasurer's Records, refer to Appendix B.

TABLE 4
SOUTH CAROLINA FARM BUREAU MARKETING ASSOCIATION
CUMULATIVE STATEMENT OF EARNINGS (LOSS) AND
RETAINED EARNINGS (ACCUMULATED DEFICIT)
GRAIN DIVISION, NORTH CHARLESTON, S.C.
YEARS ENDED JULY 31, 1963 THROUGH 1980

	<u>Cumulative Total 1963-1980</u>
Income from Operations:	
Net Sales	\$614,588,550
Income from Storage	155,563
Net Gain (Loss) from Hedging	<u>(51,187)</u>
Total Income from Operations	614,692,926
Cost of Sales	<u>599,750,340</u>
Gross Profit (Loss)	<u>14,942,586</u>
Other Income:	
Patronage Dividends	217,882
Country Points Operations	225,711
Profit Sharing - Cargill, Inc.	1,059,776
Interest	205,019
Rent	325,215
Dockage	171,981
Miscellaneous	<u>120,163</u>
Total Other Income	<u>2,325,747</u>
Total Income	<u>17,268,333</u>
Operating Expenses:	
Salaries and Wages	4,045,923
Retirement	131,524
Elevator Repairs, Maintenance and Supplies	1,173,598
Utilities	664,763
Office Supplies	31,734
Travel	165,712
Legal and Accounting Fees	206,166
Insurance and Bonding	576,059

TABLE 4 (CONTINUED)

	<u>Cumulative Total 1963-1980</u>
License and Taxes	\$ 219,730
Interest Expense and Bank Charges	538,461
Inspection and Weighing	954,132
Demurrage Charges	79,660
Fumigant	137,611
Promotion and Public Relations	39,567
Depreciation	457,878
Rent and Vehicle Expense	551,032
Bad Debts	83,063
Meeting and Board Member Per Diem	85,767
Miscellaneous	<u>179,014</u>
Total Operating Expenses	10,321,394
Reimbursement of Operating Expenses:	
Cargill, Inc.	3,335
S.C. State Ports Authority	<u>28,143</u>
Income (Loss) from Operations	6,978,417
Interest Expense	<u>118,596</u>
Income Before Income Taxes and Extraordinary Items	6,859,821
Federal Income Taxes	<u>3,549,851</u>
Income Before Extraordinary Items	3,309,970
Extraordinary Items	554,232
Allocation of Profits to State Ports Authority	<u>22,577</u>
Net Earnings (Loss)	<u>\$ 3,841,625</u>
Retained Earnings (Accumulated Deficit) at the End of Year 1980	\$ 3,468,956

Note: For Statements of Earnings (Loss) and Retained Earnings (Accumulated Deficit) for each fiscal year from 1963 through 1980, refer to Appendix D.

Source: CPA Audit Reports of Farm Bureau Marketing Association 1963-1980.

TABLE 5
COMPARISON OF FINANCIAL PROGRESS OF THE STATE
AND FBMA ON THE GRAIN ELEVATOR, 1957-1980

<u>Fiscal Years</u>	<u>State of South Carolina¹ Gross Profit (Loss) on Elevator</u>	<u>Farm Bureau Marketing Association² Net Income From Elevator</u>
1957-62	\$(200,895)	
1962-63	(119,095)	\$(68,873)
1963-64	(118,815)	(7,335)
1964-65	(87,233)	(86,631)
1965-66	(71,975)	6,376
1966-67	(37,356)	33,251
1967-68	112,835	(99,872)
1968-69	(121,313)	(132,325)
1969-70	(110,550)	(736,815)
1970-71	(284,602)	5,450
1971-72	(224,170)	193,319
1972-73	(226,483)	851,847
1973-74	(238,472)	609,504
1974-75	(203,858)	770,641
1975-76	(226,058)	962,955
1976-77	(212,567) ³	690,331
1977-78	(62,467)	275,325
1978-79	(44,574)	337,749
1979-80	(29,217)	236,728
TOTAL	<u>\$(2,506,865)</u>	<u>\$3,841,625</u>

¹Source: Refer to Appendix B.

²Source: CPA audits of FBMA Grain Division, North Charleston, South Carolina for years ending July 31, 1963-1980.

³Losses begin to decrease because of the changes made in calculating the depreciation expense (see page 21). If the depreciation schedule had not been changed in 1977 and had remained the same, losses would have been \$164,452 in FY 77-78, \$146,559 in FY 78-79 and \$131,202 in FY 79-80. Gross profit and loss figures are depicted because administrative costs are not prorated by the Ports Authority in order that the net profit or loss may be determined. This results in the costs to the State being slightly understated, since administrative costs for the elevator are estimated to have been only about \$18,000 for 1963-1980.

Noncompliance with State Law

Introduction

The grain elevator at Charleston was constructed following the issuance of general obligation bonds authorized in Act 821 of 1956. This Act was amended in 1965 by Act 486 which provided, in part, for a schedule of rates and charges to be imposed upon a per-bushel basis on all those who use the grain elevator. The per-bushel charge for the use of the grain elevator was eliminated by Section 8 of Act 1272 of 1970.

The Audit Council examined the Ports Authority's compliance with provisions of these laws as they relate to the grain elevator at Charleston. The Council found that the Ports Authority had not received annual audits of the elevator and had not submitted annual reports on its operation to the Budget and Control Board and the General Assembly. Furthermore, the Ports Authority has not adequately reviewed grain elevator operations to determine if the elevator is operated in an efficient and effective manner.

The Ports Authority has not complied with all requirements of Act 1272 of 1970 because the management of the agency was unaware of its responsibilities to review and report on operations of the grain elevator. The management of the Ports Authority believed these requirements were eliminated when the bond authorization was changed by Act 1272 of 1970 to eliminate per-bushel charges for the use of the elevator.

These areas of noncompliance with Act 1272 of 1970 are discussed in detail in the following sections.

Annual Audits of the Grain Elevator

The Ports Authority has not ensured that annual audits are performed on the grain elevator at Charleston. Annual audits of the elevator were conducted by independent auditors at the request of the Farm Bureau Marketing Association (FBMA), but the Ports Authority did not request or receive copies of the audits and did not approve the certified public accountants chosen by the FBMA to conduct the audits.

Section 8, Article 4 of Act 1272 of 1970 states:

The lessee or operator shall submit within ninety days of the end of each fiscal year a complete audit by a certified public accountant approved by the State Ports Authority.

On several occasions from April to June 1980, the Council requested copies of CPA audits of the grain elevator pursuant to Act 1272 of 1970. The Executive Director of the Ports Authority responded in a letter to the Council dated July 11, 1980, that the FBMA had not submitted any audit reports to the Authority since the fiscal year ending July 31, 1970. Following the Council's requests, the Ports Authority requested and received from the FBMA audit reports for Fiscal Years 1964 through 1979. These were forwarded to the Council for review.

Annual Reports on Grain Elevator Operations

The Ports Authority has not submitted annual reports to the Budget and Control Board and the General Assembly on the operation of the grain elevator. Section 8, Article 4 of Act 1272 of 1970 states:

The Ports Authority shall thereafter submit an annual report to the Budget and Control Board and the General Assembly, on the operation of the grain facility.

The Ports Authority receives monthly reports from the FBMA showing the type and amount of cargo handled and stored and the number of vessels handled at the grain elevator and its docks. However, this information, which could form the basis of an annual report, has not been submitted to the Budget and Control Board or the General Assembly.

Inadequate Review of Grain Elevator Operations

The Ports Authority has not reviewed the operation and status of the grain elevator to determine if it is operated in an efficient and effective manner, as required by law. Section 8, Article 4 of Act 1272 of 1970 states:

The State Ports Authority shall review at the end of each fiscal year the entire operation and status of the grain storage facilities as operated by any lessee or holder of a management contract to determine that the method and conduct of operation has been in an efficient and economical manner with due regard for the interests of the State, the farmers and the lessee.

The Ports Authority uses monthly reports from the FBMA on the amount of grain handled at the elevator to evaluate the Association's operation and degree of utilization of the elevator. However, to accomplish a review of the entire operation and status of the facilities would require a review of financial audits, on-site inspections and interviews with the management of the grain elevator.

As the State agency with responsibility for reviewing the operation of the grain elevator, the Ports Authority also has the responsibility for enforcing the law which requires that audits of the elevator be conducted at the end of each fiscal year by certified public accountants approved by the Ports Authority. Without annual reviews of the audits and operations of the grain elevator, the Ports Authority cannot

ensure that the elevator has been operated in the best interests of the State and the farmers for whom it was designed to serve. Furthermore, since the Ports Authority has not submitted annual reports to the Budget and Control Board and the General Assembly, there is no mechanism at the State level to ensure that the operation of the grain elevator is in the best interests of the State and its farmers. By not complying with all requirements of Act 1272 of 1970, the Ports Authority limits its accountability to the public and the Legislature.

RECOMMENDATIONS

SECTION 8 OF ACT 1272 OF 1970 REQUIRES THAT AT THE END OF EACH FISCAL YEAR THE PORTS AUTHORITY SHALL REVIEW THE ENTIRE OPERATION OF THE GRAIN ELEVATOR, APPROVE A CERTIFIED PUBLIC ACCOUNTANT SELECTED BY THE FARM BUREAU MARKETING ASSOCIATION TO CONDUCT A COMPLETE AUDIT, AND SUBMIT A REPORT TO THE BUDGET AND CONTROL BOARD AND THE GENERAL ASSEMBLY ON THE OPERATION OF THE ELEVATOR. TO CONFORM WITH THE PROVISIONS OF THIS ACT, THE PORTS AUTHORITY SHOULD:

- (a) REQUEST THE ASSISTANCE OF THE STATE AUDITOR AND EXERCISE ITS APPROVAL RESPONSIBILITY FOR CERTIFIED PUBLIC ACCOUNTANTS SELECTED BY THE FARM BUREAU MARKETING ASSOCIATION FOR ANNUAL AUDITS,

- (b) CONDUCT AN ANNUAL REVIEW OF THE OPERATION OF THE ELEVATOR TO INCLUDE AN EXAMINATION OF THE FINANCIAL AUDIT, ON-SITE INSPECTIONS AND INTERVIEWS WITH MANAGEMENT, AND
- (c) SUBMIT ANNUAL REPORTS TO THE BUDGET AND CONTROL BOARD AND THE GENERAL ASSEMBLY, BASED ON ITS REVIEW.

Lack of Annual Inspections of the Grain Elevator

The Ports Authority has not conducted annual inspections of the facilities and equipment at the grain elevator in Charleston. The Council reviewed the Ports Authority's compliance with conditions of the Management Agreement with the FBMA for the lease of the grain elevator and found that joint inspections of the facility have not been conducted since the agreement took effect in 1977.

The Management Agreement entered into by the South Carolina Farm Bureau Marketing Association (FBMA) and the State Ports Authority on March 11, 1977, describes the conditions under which the grain elevator is leased to the FBMA by the Ports Authority. Article VI of the Management Agreement states:

...Representatives of the parties shall make an annual, joint survey of the facilities and equipment to insure adequate maintenance and repair of such facilities and equipment. Such survey shall be made at about the anniversary of the commencement date of this Agreement at a date and time agreed upon by the parties.

In the absence of formal inspections of the facility and its equipment, the State cannot be assured that the FBMA is in compliance with

terms of the Management Agreement which require it to maintain the facility in good operating condition. Furthermore, the State cannot be completely confident that the grain elevator is structurally sound and safe for use.

Annual inspections of the elevator were not conducted after the 1977 Management Agreement because the management of the Ports Authority did not delegate these duties. Since the Audit Council began its review of the lease arrangement, an inspection of the grain elevator was conducted on May 29, 1980 by Ports Authority engineers. Additionally, in a memo on August 13, 1980, the Executive Director of the Ports Authority directed the Management Services Division to conduct annual inspections of the elevator with the FBMA. The Director of the Management Services Division was instructed to designate a professional engineer to perform this function for the Ports Authority.

RECOMMENDATIONS

THE PORTS AUTHORITY SHOULD DEVELOP CRITERIA FOR ANNUAL JOINT INSPECTIONS OF THE FACILITIES AND EQUIPMENT AT THE GRAIN ELEVATOR.

THESE INSPECTIONS SHOULD BE CONDUCTED BY A PROFESSIONAL ENGINEER FROM THE MANAGEMENT SERVICES DIVISION OF THE PORTS AUTHORITY, AND REPRESENTATIVES OF THE FARM BUREAU MARKETING ASSOCIATION IN ACCORDANCE WITH THE CONDITIONS OF THE 1977 MANAGEMENT AGREEMENT.

Identifying and Approving Plans for Improvements Needed

Introduction

On March 11, 1977, the Ports Authority entered into a Management Agreement to lease the grain elevator facilities to the South Carolina Farm Bureau Marketing Association (FBMA). This agreement is for six consecutive years beginning August 2, 1977. As part of this agreement, the FBMA agreed to spend \$2 million to improve the equipment and facilities. In addition, the agreement requires that all plans for improvements made to the elevator must be approved by the Ports Authority prior to the start of the work.

The Council's review found that the Ports Authority has no system for identifying and approving plans for improvements to the elevator. These findings are discussed in detail on the following pages.

No System to Identify Improvements

On December 8, 1980, the Audit Council requested documentation of improvements made to the grain elevator. The Executive Director of the Ports Authority stated that their internal auditors would provide an inventory of improvements made and allow the Audit Council staff to verify these improvements. Council staff met with the Ports Authority's internal auditors on December 18, 1980 at the grain elevator to identify and verify improvements. A list of improvements made to the elevator, with a value of \$1.6 million, was provided by the Ports Authority. The internal auditors compiled this list a few days prior to the Council's visit by reviewing the FBMA records in Columbia pertaining to the grain elevator. However, this list only identified the amount of money paid to vendors to make the improvements and the dates of the checks.

The list did not adequately identify or describe any improvements or equipment purchases for the elevator. Because inventory records were inadequate, the Audit Council staff could not verify any improvements to the elevator.

In addition, items valued at \$256,910 were listed as part of the improvements even though they were purchased before the Management Agreement was signed. The Council examined the list of improvements and found that some improvements were purchased in 1975 and 1976, although the agreement was not signed until March 11, 1977.

Article IV, Section B of the Management Agreement states in part:

The Association (FBMA) agrees to spend a substantial amount [approximately two million dollars (\$2,000,000)] to improve the equipment and facilities in a manner that will improve the capabilities of the grain elevator and increase the through-put capacity during the term of this agreement.

Article IV, Section C of the Management Agreement states in part:

...the title to the improvements described in Article IV (B) hereof shall remain in the Authority.

A system to accurately identify all equipment and facility improvements required in an agreement would generally be accepted as a good management practice. With such a system, management can ensure that improvements are made, equipment is delivered and accountability is maintained.

The Marketing Association has the option to renew or extend the lease on the grain elevator for 15 years if terms of the Management Agreement are faithfully performed by the Association. Without a system to identify improvements, the Ports Authority cannot determine whether the FBMA is faithfully complying with the agreement and thereby warranting extension of the lease. In addition, if the FBMA

decides not to renew its lease in 1983, the Ports Authority has no method of distinguishing its equipment from the Association's equipment.

The Ports Authority has not identified improvements to the grain elevator because management has not developed a system to identify improvements. The Ports Authority's internal auditors stated they had no system to identify improvements because they worked closely with the FBMA and were confident that the \$2 million in improvements would be made.

Plans for Improvements Not Approved

The Management Agreement between the Ports Authority and the Marketing Association requires that any improvements to the grain elevator must be approved in writing by the Ports Authority. The Audit Council asked the Ports Authority for copies of written approval given to the FBMA to make improvements to the grain elevator. No documentation was provided nor found to show that the Ports Authority had approved in writing any of the \$1.6 million in improvements as required by the agreement. The chief engineer, responsible for approving all improvements, stated the plans were verbally approved in an informal meeting with the FBMA.

The Ports Authority should have approved in writing all plans for improvements made to the grain elevator by the FBMA. Article IV, Section B of the Management Agreement states in part:

The plans and specifications of such improvements must be approved by the Authority in writing prior to commencement of work on such improvements.

The failure to approve plans for improvements to the grain elevator limits the Ports Authority's control over the disposition of improvements.

The Ports Authority cannot ensure that the best possible improvements are made to enhance the operational efficiency of the grain elevator.

RECOMMENDATIONS

THE PORTS AUTHORITY SHOULD DEVELOP A COMPLETE INVENTORY DESCRIPTION, LISTING ALL IMPROVEMENTS MADE TO THE GRAIN ELEVATOR, AND INCLUDE EQUIPMENT INFORMATION SUCH AS MANUFACTURER'S NAME, TRADE NAME, SIZE, COLOR AND SERIAL NUMBER. ALL EQUIPMENT SHOULD BE INDIVIDUALLY TAGGED AS "PROPERTY OF THE SOUTH CAROLINA STATE PORTS AUTHORITY." FACILITY IMPROVEMENTS INCLUDING FIXED EQUIPMENT SHOULD BE COMPLETELY DESCRIBED, APPRAISED, AND INCLUDED ON THE INVENTORY.

THE PORTS AUTHORITY SHOULD GIVE PRIOR WRITTEN APPROVAL FOR ANY IMPROVEMENTS OR ALTERATIONS MADE TO THE GRAIN ELEVATOR.

CHAPTER III
RELATED ISSUES

Agreement Between Farm Bureau Marketing Association and Grain Company

As part of the audit request to examine the lease arrangement between the Ports Authority and the Farm Bureau Marketing Association (FBMA), the Council was requested to determine the conditions and adverse effects of an agreement between the FBMA and a large private grain company, Cargill, Inc. The Council did not discover any adverse effects that have occurred to South Carolina farmers as a result of the agreement.

The Marketing Association entered into a Storage and Handling Agreement which restricted the use of the grain elevator to one user for three years from August 1, 1977 to July 31, 1980. The agreement required the Association to keep storage space for 1.6 million bushels of grain, the maximum capacity of the elevator, available for use by the grain company. This space would always be available to Cargill, Inc., and would not be utilized by any other party, according to the terms of the agreement. A further description of the agreement follows.

The FBMA agreed to handle and store all grain for the grain company coming into and going out of the grain elevator. The agreement stated that it was expected that the Marketing Association would make sales of grain to Cargill, Inc. The agreement further stated that in entering into the Storage and Handling Agreement, Cargill, Inc., was to a large extent relying on the FBMA to purchase grain for Cargill.

For storing grain, the Marketing Association would receive a fee from Cargill, Inc., of \$144,000 per year, whether the storage space was actually used or not. Furthermore, the Association would receive as additional storage fees a share of the profits of the grain company after all costs were deducted. For handling the grain, the FBMA would receive a handling fee of 2-3/4 cents for each bushel of grain coming into and going out of the elevator, with a minimum of 5,000,000 bushels handled annually. Other services provided by the FBMA, including drying grain, were to be charged to the grain company at cost.

The Council was informed by the FBMA that the agreement with Cargill, Inc., was renewed for three years.

Farm Bureau Marketing Association Unnecessary Party

As part of the audit request, the Council was asked to determine if the FBMA was a necessary party for the successful operation of the grain elevator as an export facility. The Council concluded that the Marketing Association is not a necessary party to successfully operate the grain export elevator. The State Ports Authority could perform the same functions being performed by the FBMA at the grain elevator. What is necessary for the successful operation of the grain elevator as an export facility is a large grain company with international ties to effectively participate in the international grain markets. The Marketing Association has contracted with a large grain company, Cargill, Inc., which is an international exporter (see page 45). Alabama is the only other State in the Southeast that owns an export elevator, and it is operated by the State.

The problem with the operation of the grain elevator is that the State is not covering all of the direct costs associated with the elevator (see page 20). This situation could be corrected by increasing the annual rental fee the Marketing Association pays to the Ports Authority for leasing the elevator. However, this remedy is hampered by the long term Management Agreement between the Ports Authority and the Association. This contract has established an annual fixed rent to be paid to the Ports Authority during the initial six-year term of the agreement and the succeeding option period of 15 years. Under the 1977 Management Agreement, the State has no option to change the annual rental fee until 1998 (see page 24).

Soybean Prices Reasonable at the Elevator

In conducting the audit of the grain elevator lease arrangement between the Ports Authority and the South Carolina Farm Bureau Marketing Association (FBMA), the Audit Council examined per-bushel prices offered to South Carolina farmers for soybeans at grain elevators around the State. Concern was expressed during the audit that farmers are being paid lower prices for grain at the Charleston elevator than at other grain elevators in the State and may be losing potential revenue as a result of the lease arrangement. The Council's analysis indicates that the prices offered farmers at Charleston were consistently higher than those offered at other grain elevators around the State. This seems to be attributed to the demand for its grain as an export commodity.

The Council compared per-bushel soybean prices offered to South Carolina farmers at the Charleston grain elevator with prices offered at other elevators to determine if farmers are receiving lower prices for

soybeans at the Charleston elevator. Soybeans were chosen for comparison because the Charleston elevator buys and stores more soybeans than other grains during the year.

The grain elevators selected for comparison with the Charleston elevator are in Anderson, Fountain Inn, Kershaw, Orangeburg and Florence. The elevators selected are each operated by different grain companies and are located in various geographical regions of the State.

Prices for soybeans were obtained from the South Carolina Department of Agriculture's Fresh Fruits and Vegetables Report, published on Tuesday, Thursday and Friday each week. The Department of Agriculture obtains the prices quoted in this report from officials at each elevator. The prices quoted are the per-bushel prices for #1 soybeans offered to South Carolina farmers at the beginning of the day the report is printed. Prices that farmers actually receive for soybeans may differ from the prices offered by the grain elevators if the elevators do not inspect and grade soybeans and base the price paid for the soybeans on specific grades. Officials at the Department of Agriculture stated that the prices offered to South Carolina farmers at the Charleston elevator may also differ from the prices offered for soybeans bought from other elevators or out-of-state farmers. This is because occasionally large quantities of soybeans may be needed to complete a full shipload of grain for export. At these times, the Charleston elevator may purchase soybeans from other elevators at higher prices than those paid to South Carolina farmers in order to get the needed grain quickly.

The Council compared Friday prices offered for #1 soybeans by all six grain elevators each week for four years from 1977-1980. When Friday prices were not available for all six grain elevators, Tuesday or

Thursday prices were used so that one day each week could be compared. Average quarterly soybean prices were figured by averaging prices over a three-month period for each elevator. Average quarterly per-bushel prices for soybeans are shown in Table 6.

The Council could find no indication that farmers receive lower prices for soybeans at the Charleston elevator than at other grain elevators in the State. The comparison showed that average quarterly prices offered to South Carolina farmers for soybeans at Charleston were consistently higher than prices offered at the other elevators from 1977-1980.

TABLE 6

AVERAGE QUARTERLY PER-BUSHEL PRICES FOR SOYBEANS AT CHARLESTON AND
OTHER GRAIN ELEVATORS IN SOUTH CAROLINA 1977-1980¹

Months/Year	Charleston	Anderson	Fountain Inn	Kershaw	Orangeburg	Florence
October-December 1980	\$8.59	\$8.22	\$8.23	\$8.42	\$8.41	\$8.28
July-September 1980	7.84	7.45	7.45	7.68	7.66	7.49
April-June 1980	6.02	5.63	5.63	5.83	5.92	5.78
January-March 1980	6.40	5.97	5.99	6.25	6.21	6.07
October-December 1979	6.52	6.06	6.14	6.23	6.31	6.25
July-September 1979 ²	-	-	-	-	-	-
April-June 1979	7.44	7.29	7.30	7.33	7.41	7.20
January-March 1979	7.43	7.11	7.11	7.16	7.27	7.10
October-December 1978	6.78	6.50	6.50	6.59	6.71	6.53
July-September 1978 ²	-	-	-	-	-	-
April-June 1978	7.19	7.06	7.06	7.05	7.06	7.03
January-March 1978	6.29	6.00	6.00	6.11	6.08	5.95
October-December 1977	6.03	5.74	5.74	5.83	5.78	5.75
July-September 1977 ²	-	-	-	-	-	-
April-June 1977	9.69	9.48	9.48	9.49	9.54	9.24
January-March 1977	7.79	7.56	7.56	7.59	7.58	7.53

¹ Average quarterly prices for soybeans were calculated by averaging the price for one day each week over a three-month period.

² Figures were not presented for these quarters because soybeans were not handled at Charleston.

Source: South Carolina Department of Agriculture, Fresh Fruits and Vegetables Reports.

The Council attempted to compare prices offered for soybeans at the Charleston grain export elevator with other export elevators at Savannah, Georgia and Norfolk, Virginia. However, price information available for Norfolk was too limited to draw any conclusions on how Norfolk soybean prices compare with Charleston prices. The Council was able to obtain soybean prices offered to farmers at the Savannah, Georgia grain export elevator for 1979 and 1980. The Council compared soybean prices offered at Charleston with prices offered at Savannah during 1979 and 1980 and found that average quarterly prices offered at Savannah were from less than 1% to 2% higher than prices offered at Charleston. An official of the S.C. Department of Agriculture stated that this is not considered a significant price difference. The soybean prices offered at Charleston and Savannah are shown in Table 7.

TABLE 7
AVERAGE QUARTERLY PRICES OFFERED FOR SOYBEANS AT
CHARLESTON AND SAVANNAH, GEORGIA FOR 1979-1980

<u>Quarter</u>	<u>Charleston²</u>	<u>Savannah, Georgia</u>	<u>Difference Amount</u>	<u>%</u>
October-December 1980	\$8.52	\$8.64	\$.12	1.4
July-September 1980 ¹	-	-	-	-
April-June 1980	5.94	6.06	.12	2.0
January-March 1980	6.46	6.47	.01	.2
October-December 1979	6.48	6.55	.07	1.1
July-September 1979 ¹	-	-	-	-
April-June 1979	7.44	7.47	.03	.4
January-March 1979	7.42	7.48	.06	.8

¹Figures were not presented for these quarters because soybeans were not handled at Charleston or Savannah.

²Average quarterly prices for Charleston shown in this table differ from average quarterly prices for Charleston shown in Table 6, page 50 because different days during the quarter were used in computing the average quarterly prices.

A farmer may sell his soybeans at any grain elevator in the State that buys soybeans, but he must pay the cost for transporting the soybeans to the elevator. Therefore, the farmer's decision on where to sell his grain is based not only on where he can receive the highest per-bushel price for the grain, but also on what his net price will be after paying transportation costs. These costs are based on a specified rate per bushel per mile. Some farmers may find that the net price for soybeans after transportation costs are paid is greater by selling to

elevators other than Charleston because hauling distances are shorter. Therefore, they may decide not to sell at Charleston where per-bushel prices are higher. Farmers would lose potential revenue by selling at the Charleston elevator only if transportation costs to Charleston reduced the net price for soybeans below the net price received from selling at a closer elevator.

Economic Impact of Grain Elevator Operation Favorable

The State has received indirect benefits of approximately \$16 million from the operation of the grain elevator from 1962-1980. A report prepared by Clemson University in 1971 entitled "An Economic Analysis of Current and Future Operations of the Charleston Elevator" addressed the economic benefits to the State from operation of the grain elevator as an export facility. Increases in the prices received for grains after the grain elevator began operation were attributed in part to the operation of the elevator as an export facility. The estimated impact to the State's total economy from the elevator from 1962-1970 was \$9.2 million, including increases in farm income and the multiplier effects of increased farm income.

The report estimated that the combined effects of increased income to grain producers and the second-round multiplier effects of increased farm income would result in a total impact to the State's economy of approximately \$7 million from 1970-1980.

The Council contacted Clemson University officials, and they stated that the operation of the grain elevator has produced indirect benefits to farm income and the State's economy as a whole, as projected in 1971. The Council concluded that the operation of the grain elevator as an export facility appears to have a positive impact on the economy of the State.

APPENDICES

APPENDIX A
PORTS AUTHORITY STATEMENT OF OPERATIONS
GRAIN ELEVATOR 1962-1980

<u>Fiscal Year</u>	<u>Income</u>	<u>Expenses</u>	<u>Gross Income Before Depreciation</u>	<u>Depreciation</u>	<u>Gross Income After Depreciation</u>
1962-63	\$ 2,067	\$ 1,201	\$ 867	\$ 68,819	\$ (67,952)
1963-64	24,148	2,767	21,381	92,153	(70,772)
1964-65	54,893	4,310	50,583	92,871	(42,289)
1965-66	41,397	4,243	37,154	93,761	(56,607)
1966-67	57,116	3,779	53,337	121,466	(68,129)
1967-68	82,596	3,652	78,945	153,823	(74,878)
1968-69	12,200	5,259	6,941	153,751	(146,810)
1969-70	24,323	23,269	1,054	153,294	(152,240)
1970-71	23,471	60,367	(36,896)	153,355	(190,251)
1971-72	25,000	9,182	15,818	152,986	(137,168)
1972-73	25,000	18,844	6,156	152,986	(146,830)
1973-74	25,000	38,181	(13,181)	152,986	(166,167)
1974-75	25,000	10,916	14,084	152,986	(138,902)
1975-76	25,000	40,465	(15,465)	152,986	(168,450)
1976-77	25,000	24,539	461	162,770	(162,308)
1977-78	60,500	29,058	31,442	51,000	(19,558)
1978-79	60,500	14,230	46,270	54,799	(8,529)
1979-80	63,309	6,782	56,526	54,864	1,662
TOTALS	\$656,520	\$301,044	\$355,477	\$2,171,656	\$(1,816,178)

Note: All figures are rounded to the nearest dollar.

Source: South Carolina State Ports Authority, Statement of Operations, Grain Elevator 1962-1980.

APPENDIX B
COMPARATIVE STATEMENT OF REVENUES, EXPENSES AND GROSS INCOME
ON THE GRAIN ELEVATOR FOR THE STATE 1957-1980

	1957-62	1962-63	1963-64	1964-65	1965-66	1966-67	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	TOTALS
Operating Revenues:																				
Dockage Fee	-	\$ 2,067	\$ 24,148	\$54,893	\$41,397	\$ 50,741	\$ 74,686	\$ 12,200	\$ 24,323	\$ 12,969	-	-	-	-	-	-	-	-	-	\$ 297,424
Share of Profits	-	-	-	-	-	6,376	7,910	-	-	10,502	-	-	-	-	-	-	-	-	-	24,788
Per Bushel Fee	-	-	-	-	22,194	154,519	302,857	115,733	-	-	-	-	-	-	-	-	-	-	-	595,303
Rental of Property	-	-	-	-	-	-	-	-	-	-	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$ 25,000	\$60,500	\$60,500	\$63,309	334,309
Miscellaneous	-	-	-	-	4,284	-	1,255	18,813	143,390	-	-	-	-	-	-	-	-	-	-	167,742
Total Revenue	-0-	2,067	24,148	54,893	67,875	211,636	386,708	146,746	167,713	23,471	25,000	25,000	25,000	25,000	25,000	25,000	60,500	60,500	63,309	1,419,566
Operating Expenses:																				
Insurance	-	1,064	1,562	1,675	1,664	1,640	1,738	1,749	1,911	7,677	7,629	7,640	7,838	8,620	10,339	11,138	9,451	9,708	6,782	99,825
Outside Services	-	-	-	-	-	-	-	-	-	1,371	-	-	-	-	-	-	-	-	-	1,371
Repairs & Maintenance Property	-	137	1,205	2,635	2,579	2,139	1,914	3,510	21,358	50,451	1,090	9,337	19,912	1,163	-	12,001	19,363	4,522	-	153,316
Repairs & Maintenance Tracks	-	-	-	-	-	-	-	-	-	868	463	1,867	10,431	1,133	30,126	1,400	244	-	-	46,532
Depreciation	-	68,819	92,153	92,871	93,761	121,466	153,823	153,751	153,294	153,355	152,986	152,986	152,986	152,986	152,986	162,770	51,000	54,799	54,864	2,171,656
Total Operating Expenses	-0-	70,020	94,920	97,181	98,004	125,245	157,475	159,010	176,563	213,722	162,168	171,830	191,167	163,902	193,451	187,309	80,058	69,029	61,646	2,472,700
Operating Income	-0-	(67,953)	(70,772)	(42,288)	(30,129)	86,391	229,233	(12,264)	(8,850)	(190,251)	(137,168)	(146,830)	(166,167)	(138,902)	(168,451)	(162,309)	(19,558)	(8,529)	1,663	(1,053,134)
Nonoperating Expenses:																				
Interest	\$200,895	51,142	48,043	44,945	41,846	123,747	116,398	109,049	101,700	94,351	87,002	79,653	72,305	64,956	57,607	50,258	42,909	36,045	30,880	1,453,731
Gross Profit (Loss) ¹	<u>\$(200,895)</u>	<u>\$(119,095)</u>	<u>\$(118,815)</u>	<u>\$(87,233)</u>	<u>\$(71,975)</u>	<u>\$(37,356)</u>	<u>\$112,835</u>	<u>\$(121,313)</u>	<u>\$(110,550)</u>	<u>\$(284,602)</u>	<u>\$(224,170)</u>	<u>\$(226,483)</u>	<u>\$(238,472)</u>	<u>\$(203,858)</u>	<u>\$(226,058)</u>	<u>\$(212,567)</u>	<u>\$(62,467)</u> ⁴	<u>\$(44,574)</u> ⁴	<u>\$(29,217)</u> ⁴	<u>\$(2,506,865)</u>

Note: ¹Gross profit and loss figures are depicted because administrative costs are not pro-rated by the Ports Authority in order that the net profit or loss may be determined. Ports Authority officials estimate administrative costs to be \$18,328 for 1962-1980.

²The per bushel fees were remitted by the FIRMA to the State Treasurer and therefore, are not shown as income to the Ports Authority in Appendix A.

³Miscellaneous income includes accrued interest on investments and reserve deposit refund. This income is not shown as income to the Ports Authority in Appendix A because actual accounting entries for the funds were done by the State Treasurer's Office on the State's ledgers.

⁴Losses begin to decrease because of the changes made in calculating the depreciation expense. If the depreciation schedule had not been changed in 1977 and had remained the same, losses would have been \$164,452 in FY 77-78, \$146,559 in FY 78-79 and \$131,202 in FY 79-80.

Source: State Ports Authority Records and State Treasurer's Records.

APPENDIX C

CASH FLOW OF THE ELEVATOR, 1957-1980

Fiscal Years	Receipts ¹ (Column A)	Costs			Total (Column B)	Cash Flow (Column A-B)
		Assets Purchased ²	Interest on Bonds ³	Operating Expenses ²		
1957-62			\$ 200,895		\$ 200,895	\$ (200,895)
1962-63	\$ 2,067	\$2,918,617	51,142	\$ 1,201	2,970,960	(2,968,893)
1963-64	24,148	1,833	48,043	2,767	52,643	(28,495)
1964-65	54,893	6,869	44,945	4,310	56,124	(1,231)
1965-66	67,875		41,846	4,243	46,089	21,786
1966-67	211,636	2,532,702	123,747	3,779	2,660,228	(2,448,592)
1967-68	386,708		116,398	3,652	120,050	266,658
1968-69	146,746		109,049	5,259	114,308	32,438
1969-70	167,713	14,798	101,700	23,269	139,767	27,946
1970-71	23,471		94,351	60,367	154,718	(131,247)
1971-72	25,000		87,002	9,182	96,184	(71,184)
1972-73	25,000		79,653	18,844	98,497	(73,497)
1973-74	25,000		72,305	38,181	110,486	(85,486)
1974-75	25,000		64,956	10,916	75,872	(50,872)
1975-76	25,000		57,607	40,465	98,072	(73,072)

APPENDIX C (CONTINUED)

CASH FLOW OF THE ELEVATOR, 1957-1980

<u>Fiscal Years</u>	<u>Receipts¹ (Column A)</u>	<u>Costs</u>			<u>Total (Column B)</u>	<u>Cash Flow (Column A-B)</u>
		<u>Assets Purchased²</u>	<u>Interest on Bonds³</u>	<u>Operating² Expenses</u>		
1976-77	\$ 25,000	\$ 28,660	\$ 50,258	\$ 24,539	\$ 103,457	\$ (78,457)
1977-78	60,500		42,909	29,058	71,967	(11,467)
1978-79	60,500		36,045	14,230	50,275	10,225
1979-80	63,309	107,555	30,880	6,782	145,217	(81,908)
TOTALS	\$1,419,566	\$5,611,034	\$1,453,731	\$301,044	\$7,365,809	\$(5,946,243)

¹See Appendix B for source of receipts.

²Source: State Ports Authority records.

³Source: State Treasury records.

APPENDIX D
FARM BUREAU MARKETING ASSOCIATION STATEMENT OF EARNINGS (LOSS)
AND RETAINED EARNINGS (ACCUMULATED DEFICIT) GRAIN DIVISION, NORTH CHARLESTON, SC
JULY 31, 1963 THROUGH 1980

	1962-63	1963-64	1964-65	1965-66	1966-67	1967-68	1968-69	1969-70	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	Total
Income From Operations:																			
Net Sales	\$2,011,769	\$10,362,511	\$14,571,229	\$18,015,800	\$30,579,742	\$40,018,396	\$12,395,648	\$18,131,475	\$8,966,502	\$12,021,994	\$21,075,268	\$32,688,069	\$47,756,624	\$58,238,848	\$71,696,293	\$50,038,627	\$69,808,706	\$96,211,049	\$614,588,550
Income From Storage	2,328	6,025	-	23,511	50,497	3,702	47,598	21,902	-	-	-	-	-	-	-	-	-	-	155,563
Net Gain (Loss) On Hedging	(59,107)	(25,041)	(152,688)	251,350	(65,701)	-	-	-	-	-	-	-	-	-	-	-	-	-	(51,187)
Total Income From Operation	1,954,990	10,343,495	14,418,541	18,290,661	30,564,538	40,022,098	12,443,246	18,153,377	8,966,502	12,021,994	21,075,268	32,688,069	47,756,624	58,238,848	71,696,293	50,038,627	69,808,706	96,211,049	614,692,926
Cost of Sales	1,923,754	10,181,050	14,184,884	17,916,394	29,886,289	39,540,382	12,153,031	18,531,897	8,779,733	11,849,564	20,682,264	32,381,612	45,799,540	55,750,801	69,510,031	48,473,326	67,841,180	94,364,608	599,750,340
Gross Profit (Loss)	31,236	162,445	233,657	374,267	678,249	481,716	290,215	(378,520)	186,769	172,430	393,004	306,457	1,957,084	2,488,047	2,186,262	1,565,301	1,967,526	1,846,441	14,942,586
Other Income:																			
Patronage Dividends	4,924	13,680	16,788	12,042	31,452	60,676	44,435	33,885	-	-	-	-	-	-	-	-	-	-	217,882
Country Point Operations	-	-	-	-	-	-	-	-	32,374	11,085	104,795	77,457	-	-	-	-	-	-	225,711
Profits Sharing - Cargill, Inc.	-	-	-	-	-	-	-	-	-	34,124	507,733	517,919	-	-	-	-	-	-	1,059,776
Interest	-	-	-	-	-	-	-	-	-	1,612	8,247	16,856	41,924	35,390	16,198	6,744	21,895	56,153	205,019
Rent	-	-	-	150	180	180	410	870	-	107,790	108,955	106,680	-	-	-	-	-	-	325,215
Dockage	-	-	-	-	-	-	-	-	-	33,579	72,033	66,369	-	-	-	-	-	-	171,981
Miscellaneous	1,337	-	-	4	5	5	9,180	260	7,047	18,887	7,178	7,224	730	4,099	7,218	49,186	877	6,926	120,163
Total Other Income	6,261	13,680	16,788	12,196	31,637	60,861	54,025	35,015	39,421	207,077	808,941	792,505	42,654	39,489	23,416	55,930	22,772	63,079	2,325,747
Total Income	37,497	176,125	250,445	386,463	709,886	542,577	344,240	(343,505)	226,190	379,507	1,201,945	1,098,962	1,999,738	2,527,536	2,209,678	1,621,231	1,990,298	1,909,520	17,268,333
Total Operating Expense	106,370	183,460	337,076	373,711	497,974	603,416	439,452	432,040	232,516	237,248	339,910	325,458	494,097	669,581	1,062,967	1,119,524	1,372,504	1,494,090	10,321,394
Reimbursement Of Operating Expenses																			
Cargill, Inc.	-	-	-	-	-	-	-	-	2,944	391	-	-	-	-	-	-	-	-	3,335
S.C. State Ports Authority	-	-	-	-	-	-	-	-	27,782	361	-	-	-	-	-	-	-	-	28,143
Income (Loss) From Operations	(68,873)	(7,335)	(86,631)	12,752	211,912	(60,839)	(95,212)	(775,545)	24,400	143,011	862,035	773,504	1,505,641	1,857,955	1,146,711	501,707	617,794	415,430	6,978,417
Interest Expense	-	-	-	-	-	39,033	37,113	-	17,035	15,227	10,188	-	-	-	-	-	-	-	118,596
Income Before Income Taxes and Extraordinary Items	(68,873)	(7,335)	(86,631)	12,752	211,912	(99,872)	(132,325)	(775,545)	7,365	127,784	851,847	773,504	1,505,641	1,857,955	1,146,711	501,707	617,794	415,430	6,859,821
Federal Income Taxes	-	-	-	-	-	-	-	-	-	57,000	416,421	304,921	735,000	895,000	456,380	226,382	280,045	178,702	3,549,851
Income Before Extraordinary Items	(68,873)	(7,335)	(86,631)	12,752	211,912	(99,872)	(132,325)	(775,545)	7,365	70,784	435,426	468,583	770,641	962,955	690,331	275,325	337,749	236,728	3,309,970
Extraordinary Items	-	-	-	-	(164,375)	-	-	38,730	-	122,535	416,421	140,921	-	-	-	-	-	-	554,232
Allocation Of Profits To State Ports Authority	-	-	-	6,376	14,286	-	-	-	1,915	-	-	-	-	-	-	-	-	-	22,577
Net Earnings (Loss)	\$ (68,873)	\$ (7,335)	\$ (86,631)	\$ 6,376	\$ 33,251	\$ (99,872)	\$ (132,325)	\$ (736,815)	\$ 5,450	\$ 193,319	\$ 851,847	\$ 609,504	\$ 770,641	\$ 962,955	\$ 690,331	\$ 275,325	\$ 337,749	\$ 236,728	\$ 3,841,625
Retained Earnings (Accumulated Deficit) At Beginning Of Year	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	(1,142,083)	(1,136,665)	(943,346)	(91,499)	518,005	1,299,110	1,928,823	2,619,154	2,894,479	3,232,228	
Retained Earnings (Accumulated Deficit) At End Of Year	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	\$ (1,136,633)	\$ (943,346)	\$ (91,499)	\$ 518,005	\$ 1,288,646	\$ 2,262,065	\$ 2,619,154	\$ 2,894,479	\$ 3,232,228	\$ 3,468,956	

Source: CPA Audit Reports of the Farm Bureau Marketing Association,
1963 - 1980.

APPENDIX E

ACT 1272 OF 1970

(R1279, H2545)

An Act To Amend Act No. 1377 Of 1968, As Amended, Relating To State Capital Improvement Bonds, So As To Increase The Amount Of State Capital Improvement Bonds That May Be Issued Pursuant Thereto, To Prescribe New Purposes For Which The Proceeds From Such Bonds May Be Expended, To Further Define The Conditions Under Which Certain Bonds Now Authorized And Those Bonds Herein Authorized May Be Issued And To Remove Certain Limitations And Conditions Imposed, To Amend Act No. 821 Of 1956, As Amended, Relating To The State Ports Authority, So As To Eliminate The Per Bushel Charge Imposed For The Use Of The Grain Elevator And To Provide For Certain Refunds.

Be it enacted by the General Assembly of the State of South Carolina :

SECTION 1. As an incident to the enactment of this act, the General Assembly has made the following findings:

1. By Act No. 1377 of 1968 provision was made for the issuance of State Capital Improvement bonds (bonds). In that act the General Assembly reserved the right to afterwards amend it by enlarging the limitations therein imposed as to the amount of bonds that might thereafter be outstanding pursuant to the act and by adding new purposes for which the proceeds of bonds may be expended.

2. Act No. 1377 was amended in 1969 as follows:

- (a) Part II, Section 12 of Act 349;
- (b) Act No. 456; and
- (c) Part II, Section 2 of Act No. 452.

3. It is now intended to further enlarge the limitations imposed as to the amount of bonds that may be outstanding pursuant to Act No. 1377, to add new purposes for which the proceeds of bonds may be expended, to remove certain limitations and conditions imposed with respect to the authorization set forth in Act No. 456 of 1969, and to impose conditions upon the issuance of the additional bonds authorized by this act.

SECTION 2. In addition to the purposes for which bonds may be issued pursuant to Act No. 1377 of 1968, as amended, bonds may be issued to provide funds for the following specific purposes but within the limitations set forth after each purpose in this section:

APPENDIX E (CONTINUED)

ACT 1272 OF 1970

SECTION 8. Section 3 of Act No. 821 of 1956, as last amended by Act No. 486 of 1965, is amended to read as follows:

"Section 3. Prior to the issuance of any State Ports bonds, the Authority shall transmit to the State Budget and Control Board (herein called the State Board) a request for the issuance thereof, and shall embody in such request the following information:

(1) A schedule showing the aggregate of State Ports bonds issued pursuant to previous requests; the purposes for which the proceeds thereof were expended; and the annual debt service requirements thereof.

(2) The amount of bonds then sought to be issued, the purposes for which their proceeds are to be expended, and a suggested maturity schedule for such bonds.

(3) A schedule showing estimated future debt service requirements on all outstanding State Ports bonds and the bonds then requested to be issued.

(4) The State Ports Authority shall review at the end of each fiscal year the entire operation and status of the grain storage facilities as operated by any lessee or holder of a management contract to determine that the method and conduct of operation has been in an efficient and economical manner with due regard for the interests of the State, the farmers and the lessee. The lessee or operator shall submit within ninety days of the end of each fiscal year a complete audit by a certified public accountant approved by the State Ports Authority. The Ports Authority shall thereafter submit an annual report to the Budget and Control Board and the General Assembly, on the operation of the grain facility.

(5) That any option in any existing contract or management agreement shall be terminated and at the termination of the existing management contract or lease, the State Ports Authority shall have the right and responsibility of operating or leasing the facilities on such terms as they may deem best. *Provided*, that first priority in negotiating any new agreement or lease shall be given to the then existing operator or lessee."

SECTION 9. Section 6 of Act No. 821 of 1956, as last amended by Act No. 1159 of 1966, is amended to read as follows:

"Section 6. For the payment of the principal and interest on all State Ports bonds at any time issued and outstanding pursuant to this act as now constituted or as hereafter amended, there shall be pledged the full faith, credit and taxing power of the State of

APPENDIX E (CONTINUED)

ACT 1272 OF 1970

South Carolina, and in addition thereto, but subject to the provisions of this section, the entire amount of revenue derived from the tax levied on income, pursuant to Chapter 5 of Title 65, Code of Laws of South Carolina, 1962, as amended. The revenues derived from such tax during each fiscal year shall be discharged from such pledge when provision has been made for the payment in full of the principal and interest of all State Ports bonds matured or maturing in such fiscal year. In addition to the revenues derived from such income tax, there shall be applied to the payment of such State Ports bonds annually such amounts from the net revenues derived by the Authority from its operations, not pledged to the payment of revenue bonds of the Authority now or hereafter outstanding, which have been issued by the State Ports Authority pursuant to Article 5, Chapter 1, Title 54, Code of Laws of South Carolina, 1962, as shall from time to time be determined and directed by the State Budget and Control Board (except that all revenues derived from the per bushel charge authorized by Item (4) of Section 3 of Act No. 821 of 1956, as amended, shall be pledged and set apart as hereinafter prescribed only to the payment of bonds to be issued for the expansion of facilities at the Port of Charleston for storing and exporting soy beans and other small grains); and if the State Budget and Control Board shall, by resolution duly adopted, approve the issuance of bonds by the State Ports Authority pursuant to the provisions of Article 5, Chapter 1, Title 54, Code of Laws of South Carolina, 1962, payable from any specified revenues, such pledge shall preclude the use of such revenues for the payment of principal and interest of State Ports bonds issued pursuant to Act 821 of 1956 as now or hereafter amended.

The pledge of the revenues derived from such income tax shall preclude the repeal of such tax until such pledge has been fully discharged but it shall not preclude the revision of such tax as to rate, if the State Auditor shall certify that his estimate of the revenue to be derived annually from the tax as thus revised will not be less than one hundred and fifty per cent of that sum which is equal to the maximum annual principal and interest requirements on all State Ports bonds outstanding, or then requested to be issued on the date such certificate bears. Such certificate shall be appended to the enrolled act and be presented to the Joint Assembly of the General Assembly on the occasion such act is presented for ratification."

APPENDIX E (CONTINUED)

ACT 1272 OF 1970

SECTION 10. Any funds being held in escrow and any funds derived from the lessee-operator of the grain elevator since July 1, 1969, shall be returned to the lessee-operator.

SECTION 11. This act shall take effect upon approval by the Governor.

In the Senate House the 23rd day of April

In the Year of Our Lord One Thousand Nine Hundred and Seventy.

JOHN C. WEST,
President of the Senate.

SOLOMON BLATT,
Speaker of the House of Representatives.

Approved the 23rd day of April, 1970.

ROBERT E. MCNAIR,
Governor.

APPENDIX F

Introduced by Messrs. Yarborough, Thomas E. Smith, Jr., Goodman, Earle, Hawkins.

A HOUSE RESOLUTION

REQUESTING THE STATE PORTS AUTHORITY TO EXTEND ITS CONTRACT WITH THE FARM BUREAU MARKETING ASSOCIATION FOR THE OPERATION OF THE GRAIN ELEVATOR IN CHARLESTON FOR ONE YEAR.

WHEREAS, the Farm Bureau Marketing Association, by its operation of the grain elevator in Charleston under contract with the State Ports Authority has provided a beneficial influence on the grain market in this State with a resulting benefit to the State's economy in general; and

WHEREAS, it appears in analyzing the operation of the grain elevator the Farm Bureau Marketing Association has operated it with prime concern for the grain producer in keeping with the intent of the General Assembly when legislation providing for the grain elevator was enacted; and

WHEREAS, it has been learned that the present contract between the Farm Bureau Marketing Association and the State Ports Authority expires June 30, 1971; and

WHEREAS, it appears that the Farm Bureau Marketing Association has improved and strengthened the operation of the grain elevator.

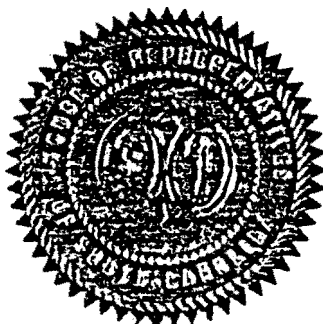
NOW, THEREFORE,

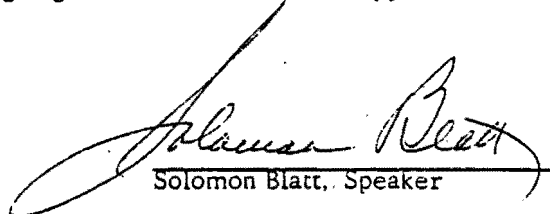
BE IT RESOLVED by the House of Representatives of the State of South Carolina:

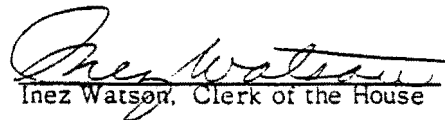
THAT the South Carolina State Ports Authority is hereby requested to extend its present contract with the Farm Bureau Marketing Association for the operation of the grain elevator in Charleston until June 30, 1972.

State of South Carolina
In the House of Representatives
Columbia, South Carolina
June 22, 1971

We hereby certify that the foregoing is a true and correct copy of a Resolution passed in the House of Representatives.




Solomon Blatt, Speaker


Inez Watson, Clerk of the House

APPENDIX G

STATE OF SOUTH CAROLINA
OFFICE OF THE ATTORNEY GENERAL
COLUMBIA

OPINION NO. 81-

June 15, 1981

SUBJECT: Public Funds, State Ports Authority

SYLLABUS:

- (1) The management agreement between the State Ports Authority and Farm Bureau Marketing Association regarding the operation of the grain elevator at the North Charleston Terminal is not a legal contract based upon information provided to this office by the Legislative Audit Council.
- (2) A management agreement between the State Ports Authority and a private corporation which calls for an annual leasing amount which is less than the total costs to the State is violative of Section 8, Act 1272 (1970).

TO: George L. Schroeder
Director
Legislative Audit Council

FROM: Clifford O. Koon, Jr.
Assistant Attorney General

QUESTIONS:

1. Is the management agreement between the State Ports Authority and Farm Bureau Marketing Association regarding the operation of the grain elevator at the North Charleston Terminal a legal contract?

2. Can the State Ports Authority lease a facility constructed with State funds for a lease amount that does not cover all costs to the State?

OPINION

Page Two

STATUTE AND CASES:

Act 1272 §8, Acts and Joint Resolutions (1970); §33-47-10 Code; §54-3-130 Code; §54-3-140 Code; §54-3-1010 Code; Elliott v. McNair, 250 S.E. 75, 156 S.E.2d 421 (1967); Harper v. Schooler, 258 S.C. 486, 189 S.E.2d 284 (1972).

OTHER MATERIALS CITED:

Article X, §8, Constitution of South Carolina.

OPINION

Page Three

I.

This opinion is based upon certain factual information provided to this office by the staff of the Legislative Audit Council. Although this opinion is based upon those premises, it makes no representations as to their accuracy or to the accounting principles upon which they were formulated. The facts provided to this office are as follows: First, you have indicated that bonds were issued by the State to raise funds for the construction and equipping of the grain elevator in the State Ports Authority's (Authority) facility at the North Charleston terminal. Secondly, the principal and interest upon those bonds are being paid by the Treasurer of South Carolina out of public funds generated by taxation. Third, under the management agreement between the Authority and the Farm Bureau Marketing Association (Association) the grain elevator is being leased at an annual fee which does not cover the total costs to the State, but the Association (which is organized as an eleemosynary non-profit corporation under Section 33-47-10, et. seq.) is now showing a profit under the agreement. Fourth, the State has shown a net loss during the entire duration of the management agreement and the loss is projected to continue throughout the life of the agreement. Fifth, there has been non-compliance with Section 8 of Act 1272 (1970), which mandates annual reviews, audits, and reports

OPINION

Page Four

to the Budget and Control Board. Sixth, the association has accumulated retained earnings of approximately 3.5 million dollars.

II.

The answer to your first question requires a two-pronged analysis. First, it must be determined whether or not the action taken by the Authority was for a public purpose. It is undisputed that no public funds may be appropriated or expended for private purposes. Article 10, Section 8, Constitution of South Carolina; Attorney General's Opinions, 1962 #1363, pg. 136.

The Authority was created by statute to, among other things, "do and perform any act or function which may tend to or be useful toward the development and improvement of such harbors and seaports of this State and to the increase of water-borne commerce, foreign and domestic, through such harbors and seaports." Section 54-3-130, SOUTH CAROLINA CODE OF LAWS, 1976. To this end, the Authority may rent, lease, buy, or sell real or personal property as it may deem proper. Section 54-3-140, CODE. The Authority may issue bonds for the financing of its mandated functions provided the issuance of the bonds meets constitutional and statutory guidelines. Section 54-3-1010, CODE.

Bonds were issued in 1956 for the construction and equipping of new port facilities, including a grain elevator in the Authority's North Charleston terminal. Thereafter, the Authority executed a management

OPINION

Page Five

agreement with the Association for the operation of the grain elevator.

It is clear from a review of the relevant case law that the promotion of trade, commerce, and industrial development is a proper public purpose. Elliott v. McNair, 250 S.C. 75, 156 S.E.2d 421 (1976); Harper v. Schooler, 258 S.C. 486, 189 S.E.2d 284 (1972).

In the Elliott case the Board of Administrators of Richland County issued bonds in conjunction with an arrangement which allowed a large manufacturing firm to locate in Richland County. In a buy and lease-back arrangement, the Board used the funds to allow the company to, in effect, build a plant at very favorable interest rates. The Supreme Court held that the action taken by the Board was in promotion of the industrial development of Richland County and was, therefore, a proper public purpose.

In the Harper case the Georgetown County Board of Commissioners negotiated a bond agreement which allowed the construction of pollution control facilities at a privately owned paper mill which had been discharging a harmful amount of effluents into the Sampit River. In spite of plaintiff's arguments that the paper mill was required by federal law to clean up the pollutants in any case, the Supreme Court held that protection of the environment from water pollution and the efforts to assure that the paper mill remained operative in Georgetown

OPINION

Page Six

County were proper public purposes. Applying the same analysis to the matter at hand leads to the inescapable conclusion that the efforts of the Authority in this instance constituted the proper public purpose of promoting the water-borne commerce in agricultural products through the harbor at Charleston.


Although the contract was entered into for a valid public purpose, it would nevertheless be necessary to determine whether or not this public purpose is being carried out within the statutory and constitutional provisions which control the Authority's activities. Viewed from this perspective the agreement appears to be constitutionally suspect because, according to facts provided by your staff, this agreement has caused a net loss to the State while providing a private corporation with a profit. This not only is violative of Section 8, Act 1272 as not being in the best interest of the State, but has the appearance of using State funds for the benefit of a private corporation.

Although you have presented two questions, they are answerable as one, in that it is the opinion of this Office that the agreement between the Authority and the Association appears not to be valid because this arrangement seems to require a yearly expenditure of State funds to subsidize the operation of an enterprise upon which a private

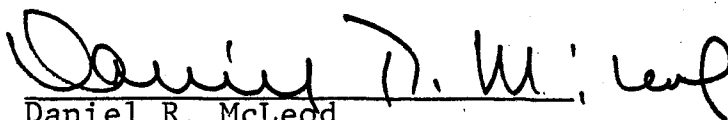
OPINION

Page Seven

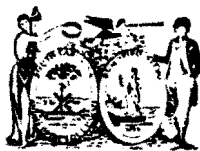
corporation is making a profit. Therefore, the agreement does not constitute a legal contract, based on the information provided in your letter.


Clifford O. Koon, Jr.
Assistant Attorney General

REVIEWED AND APPROVED BY:


Daniel R. McLeod
Attorney General

The State of South Carolina



Office of the Attorney General

DANIEL R. McLEOD
ATTORNEY GENERAL

REMBERT C. DENNIS BUILDING
POST OFFICE BOX 11549
COLUMBIA, S.C. 29211
TELEPHONE 803-758-2072

October 21, 1981

Mr. George L. Schroeder
Director
Legislative Audit Council
620 Bankers Trust Tower
Columbia, South Carolina 29201

Dear Mr. Schroeder:

This is in response to your opinion request of September 17, 1981, wherein you asked the following questions regarding the Management Agreement between the South Carolina Ports Authority (Authority) and the South Carolina Farm Bureau Marketing Association (Association):

1. Does Article IV(B) of the Management Agreement unequivocally obligate the Association to an expenditure of \$2,000,000.00 to improve the equipment and facilities in a manner that will improve the capabilities of the grain elevator and increase the through-put capacity during the term of the agreement?

2. Would Articles II and IV(B) of the Agreement provide that an additional \$2,000,000.00 or more be spent for improvements if the Association renews or extends the present lease for an additional fifteen years following the initial six year term?

3. What does Article IV(B) mean in requiring the Association to "...make such improvements and adaptations as are necessary to keep the equipment suitable for use in the then current trade....?" Would this require that at the termination of the Management Agreement that the grain elevator and storage facilities be up to the state-of-the art technology at that time or that they be maintained and in a satisfactory operation condition as indicated in Article VI?

Mr. George L. Schroeder
October 21, 1981
Page Two

In answer to your first question, when words of a contract are clear and unambiguous, the intention expressed and indicated thereby controls. 17 Am.Jur.2d "Contracts" §241, Hartford Accident and Indemnity Co. v. Hood, 266 N.C. 706, 40 S.E.2d 198. Article IV(B) obligates the Association to "spend a substantial amount (approximately two million dollars [\$2,000,000.00]) to improve the equipment and facilities in a manner that will improve the capabilities of the grain elevator and increase the through-put capacity during the term of this Agreement." The ambiguous term "substantial amount" is rendered unambiguous by the parenthetical definition "approximately two million dollars." The Agreement contains no language which would limit, qualify, or otherwise reduce or excuse the expenditure of this amount during the term of the Agreement. Therefore, it is the opinion of this office that the Association is unequivocally bound by the terms of the Management Agreement to expend approximately two million dollars during the term of the Agreement to improve the equipment and facilities in such a manner that will improve the capabilities of the grain elevator and increase the through-put capacity thereof.

Your second question is answered in much the same way as your first, as the terms of the Agreement regarding contract period and renewal option are clear and unambiguous. Article II states that the lease period shall run for a period of six years and grants the Association an option to renew or extend the lease "on the same terms and conditions" for an additional period of fifteen years. If the Association chooses to exercise its option at the termination of the present contract term, it must thereby accept and effectuate the identical terms of the original Agreement, including the requirement for expenditures found in Article IV(B). It is the opinion of this office that the Association would be bound to spend an additional two million dollars over the term of the extension consistent with the terms of Article IV(B) in the event that the Association exercises the option available to it under Article II.

In answer to your final question, the intention of the parties to a contract is to be gathered from the whole scope and effect of the language used in the contract. Greenwood Manufacturing Co. v. Worley, 222 S.C. 156, 71 S.E.2d 889 (1952). In order to accomplish this with the matter at hand, it is necessary to reconcile or explain the apparent differences in the wording of Articles IV(B) and VI with respect to maintenance of equipment and facilities.

Mr. George L. Schroeder
October 21, 1981
Page Three

Article VI deals with routine maintenance and further requires the Association to surrender the equipment and facilities at the end of the term in "operating condition." Article IV(B), as stated above, deals with maintaining and improving the equipment and facilities in such a manner as to keep them suitable for use in the "then current trade."

Article IV(B) protects the authority against the functional obsolescence of its equipment and facilities by imposing a spending requirement upon the Association for improvements in capability and through-put capacity. Functional obsolescence is "the loss in value which occurs within a structure as a result of its inability to perform adequately the function for which it should be used." Real Property Appraiser's Handbook, U.S. Army Corps of Engineers, October, 1955. For example, if changes in the size or configuration of the grain vessels over the term of this agreement were to make it difficult or impossible to load them at the Authority's facility, Article IV(B) contemplates modifications or other improvements in the equipment and facilities at the expense of the Association to render the facility capable of operating in the "current trade."

Article VI protects the Authority from premature depreciation of facilities and equipment because of neglect or lack of maintenance. It places the duty of routine maintenance squarely upon the Association and further requires the facilities and equipment to be surrendered at the end of the lease term in "operating condition."

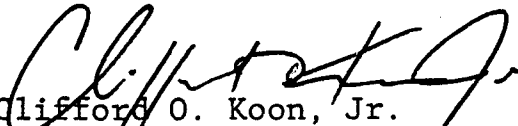
The problem to be inferred from your third question is whether or not there is a possibility under this Management Agreement that the facilities and equipment could at some future time be surrendered which are technically in working order, but are not suitable for use in the "then current trade." The answer to this problem is found by adhering to the requirement of considering the entire scope and effect of the contract. Articles IV(B) and VI, read together, protect against two separate problems and are, therefore, not inconsistent. It is the opinion of this office that these two Articles, read together, require that upon termination of the agreement, the Association must surrender the equipment and facilities to the Authority in proper working order and in such a condition that they are suitable for use in the "then current trade," which is defined as not being functionally obsolete.

APPENDIX H - CONTINUED

Mr. George L. Schroder
October 21, 1981
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I trust that this has satisfactorily answered your questions. If not, please feel free to call at your convenience.

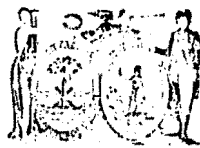
Sincerely,


Clifford O. Koon, Jr.
Assistant Attorney General

COKjr:prl

REVIEWED AND APPROVED BY:


Daniel R. McLeod
Attorney General



APPENDIX I

STATE OF SOUTH CAROLINA

OFFICE OF THE STATE AUDITOR

P.O. BOX 11333

COLUMBIA

29211

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January 22, 1982

Mr. George L. Schroeder, Director
Legislative Audit Council
620 Bankers Trust Tower
Columbia, South Carolina 29201

Dear George:

At the request of Carl Jordan of your staff, we reviewed a draft of the proposed response by the Council to comments as received from the South Carolina Ports Authority concerning the grain elevator lease arrangements with the South Carolina Farm Bureau.

As a result of our review, we submit the following comments and suggestions on the proposed Council response:

1. Suggest expansion of paragraph describing understatement of depreciation expense. Specifically point out that 71 years to depreciate equipment is a gross overstatement of useful life as can be seen by the economical analysis footnote (1) which states that the 1962 original equipment costing \$1,300,000 had to be apparently completely replaced in 1977. Thus 15 years is apparently a reasonable useful life for equipment, depreciating these items over 71 years is a gross understatement of expense. Footnote (1) also indicates that equipment installed in 1977-1983 period will require replacement by 1998, further evidence of a 15 year life.
2. The economic analysis indicates that per the 1977 Management Agreement, the Authority was relieved of all repair and maintenance costs. Therefore the estimated effects of such relief covering the period 1981-1998 totalling \$480,093 are shown as a contractual benefit (see economic analysis footnote 2). Presenting relief from expending \$480,093 for maintenance and repairs as a benefit presents a distorted picture of the situation. A prudent lessor should have been recovering such costs as a portion of the rent charged to the lessee, therefore if the lease agreement is re-negotiated to provide that the lessee shall henceforth be responsible for maintenance and repair it should be apparent that the lessee's reimbursement to the lessor in the form of rent would be correspondingly reduced. Therefore, while the lessor is relieved of an expenditure, they would also lose the reimbursement for such expenditures and thus be in no better position than under the prior agreement. In other words it should be a net situation for the lessor, no economic gain would be realized.

APPENDIX I (CONTINUED)

Mr. George L. Schroeder
Page 2
January 22, 1982

3. The \$6.1 million of equipment and improvements shown as a contractual benefit presents a distorted economic analysis. As currently shown, there is no depreciation reflected in the analysis for the \$6.1 million of equipment and improvements. Obviously, equipment and improvements should be depreciated.

Should you have any further questions concerning this matter please do not hesitate to get in touch with us.

Very truly yours,



Edgar A. Vaughn, Jr., CPA
State Auditor

EAV:ml

Suite 301
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Columbia, South Carolina 29202
(803) 771-7575
Cable DEHANDS

January 28, 1982

Mr. George L. Schroeder
Director
Legislative Audit Council
State of South Carolina
620 Bankers Trust Tower
Columbia, South Carolina 29201

Dear Mr. Schroeder:

We apologize for the delay in responding to your letters of November 30 and December 18, 1981 requesting certain information regarding the South Carolina State Ports Authority ("Ports Authority") and its grain elevator. Your requests unfortunately could not have come at a more inopportune time for us in that this is our busiest time of the year and we were in the process of moving our office.

Prior to your letters, Ms. Carol Routh of your office made requests of us that were similar to the ones contained in your letters. In conversations with Ms. Routh, we gave tentative responses that are consistent with the responses in this letter.

Since the accounting methods used for the grain elevator costs do not materially affect the financial statements of the Ports Authority taken as a whole, we have not previously or currently undertaken a specific and in-depth review of the related facts and circumstances. Should you desire that we do so, we will be happy to discuss such a review with you.

In connection with your requests we reviewed our correspondence files and working papers and found nothing specific in them related to the grain elevator. We also have discussed the matter with a former employee who was the supervising manager for our services to the Ports Authority at the time the depreciation changes were made. His recollections were generally that we did not perform any specific research on the matter but that we did discuss the matter with Ports Authority Management ("PAM") when questions were raised of us concerning their proposed accounting treatment. His recollections were that, based upon the terms of the agreement with the Farm Bureau Marketing Association:

PAM reasonably concluded that the agreement resulted in a situation in which the accounting for the grain elevator costs needed to be modified.

Mr. George L. Schroeder

January 28, 1982

2

- . There was some justification for writing off the grain elevator costs over some extended period of time.
- . The effect of the difference between what PAM were proposing and what we might recommend, had we performed a specific study of the matter, was not material to the financial statements of the Ports Authority taken as a whole (a position that we as independent auditors must take).

The financial statements (and related notes) of the Ports Authority (contained in the financial audit report that contained our opinion) are the representations of the PAM. The notes to the financial statements include disclosure about the general (i.e. not specific as to each individual asset) depreciation methods and useful life ranges used for all Ports Authority fixed assets, as is required by generally accepted accounting principles (Accounting Principles Board Opinion Number 12).

The issues involved in depreciation accounting are frequently not clear and simple, and many situations are such that they require careful analysis of the facts and circumstances to determine a reasonable and appropriate accounting treatment. One of the responsibilities of management of an entity is to perform such analysis and to establish the accounting treatment. A responsibility of the external auditor is to determine that the financial statements (resulting from the accounting policies and procedures adopted by an entity's management), taken as a whole, "fairly present" the financial position, results of operations, and changes in financial position in accordance with generally accepted accounting principles consistently applied. In other words, the external auditor is concerned with the financial statements taken as a whole.

We hope that this letter has been responsive to your requests and that it will be of assistance to you in your examination.

Yours truly,



David N. Vannort
Partner-in-Charge

cc: Edgar Vaughn - State Auditor
David R. Smith - Assistant State Auditor

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SOUTH CAROLINA STATE PORTS AUTHORITY

Post Office Box 817, Charleston, South Carolina 29402 Telephone 803/723-8651

G. Luther Rosebrock
DIRECTOR
FINANCE

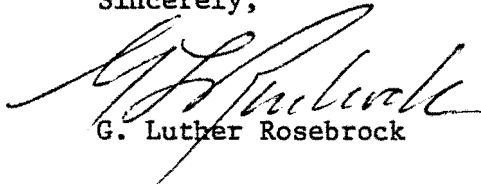
May 4, 1982

Mr. George L. Schroeder, Director
South Carolina Legislative Audit Council
620 Bankers Trust Tower
Columbia, South Carolina 29201

Dear Mr. Schroeder:

At the request of Mr. W. Don Welch, Executive Director of the State Ports Authority, I am forwarding our response to the Legislative Audit Council's report on the grain elevator which we reviewed Monday, April 26, 1982.

Sincerely,



G. Luther Rosebrock

GLR:rl

Enclosure



**Response of the South Carolina State Ports Authority
to the Report of the Legislative Audit Council
May 4, 1982**

I. General

The South Carolina State Ports Authority takes strong exception to the report's criticism of the Management Agreement between the Authority and the Farm Bureau Marketing Association (hereinafter referred to as the Farm Bureau). The Agreement provides for the operation of the grain elevator at the North Charleston Terminal commensurate with a mandate of the South Carolina General Assembly. The report itself cites ample evidence of the grain elevator's past and present benefit to the farmers and general economy of South Carolina. Concurrently, the Authority contends the Agreement has been a positive factor in historic agricultural advances and that it assures continued success in terms of satisfying both the needs of farmers and the intent of the General Assembly, which mandated construction of the grain elevator. The Ports Authority asserts that the Agreement is a valid and sensible means of furthering South Carolina's interests.

The basic fallacy of the Audit Council's report is its application of inappropriate standards to an evaluation of the Management Agreement. The Council views benefits from the Agreement in the narrow perspective of a private landlord who has no interest in the tenant's operation, other than the collection of rent. The Audit Council considers no benefits to the State, other than the rent collected, and, furthermore, appears to argue that the assessment and collection of rent is the single-most important aspect of the Agreement. However, the public benefit of a public facility is not incidental; it is fundamental to the creation and operation of such a structure.

The appropriate and correct standard is that set forth in the statutes of the State of South Carolina. The General Assembly's Act 626 of 1942 directs the Ports Authority "to acquire, construct, equip, maintain, develop and improve port facilities, and, to foster and stimulate the movement of freight and commerce through the South Carolina ports." See specifically, Section 54-3-130 Code of Laws of South Carolina, 1976. Act 821 of the 1956 General Assembly specifically directed the Ports Authority ". . . to provide adequate facilities for exporting soy beans and other small grains . . ."

Within this legislative framework the Ports Authority in 1977 sought to negotiate a management agreement that would better meet the needs of tens of thousands of farmers in this State; provide additional equipment and facilities; improve technologically obsolete equipment and provide additional future improvements at no cost to the State; protect the State from the rising inflation of repair and maintenance costs; and protect and enhance the State's investment.

The agreement in question substantially complies with all of the recommendations of a report prepared in 1971 by Clemson University and the University of South Carolina entitled "An Economic Analysis of Current and Future Operations of the Charleston Elevator", in particular the recommendations that this facility be operated by an independent contractor interested in exports and that a fixed rental sum be collected, leaving to the operator the profit or loss from his operations. The Farm Bureau is independent, non-profit, and has the special interests of South Carolina farmers in mind.

The Clemson-USC study also suggests that the optimum rental fee to be expected from an elevator operator would be \$40,000 to \$60,000 a year. The 1971 study goes on to say that rental fees alone would probably never be sufficient to pay off the principal and interest on the bonds issued to construct the elevator. The 1977 Management Agreement achieved for the State a rental fee of \$60,500, in addition to numerous other benefits.

Again, the report's criticism of the Management Agreement stems only from its position that the rent charged the Farm Bureau is not sufficient to offset the State's costs in funding the elevator. The Council fails to appreciate factors crucial to a basic understanding of the beneficial aspects of the instrument. In particular, the Ports Authority calls attention to the following information:

- 1) This elevator at the North Charleston Terminal now handles more than 17 million bushels of grain each year and had effected a \$16,000,000 benefit to the State by 1980.
- 2) The Agreement with the Farm Bureau is a Management Agreement, not a lease designed to achieve rent only. The lease of facilities and property to the Farm Bureau is an incidental feature of the Agreement. Again, its single, overriding purpose is to achieve management and operation of the grain export facility for South Carolina farmers.
- 3) Besides rent, the 1977 Management Agreement achieves the following benefits for the State: the operation and management of the facility (which costs the Farm Bureau more than \$1,000,000 per year and which the Ports Authority has no present capacity to provide); the complete maintenance and repair of the facility; the renewal and complete modernization of the facilities during the term of the Agreement (the cost of which, considering inflation, would probably be substantial in later years of the Agreement); and the expenditure by the Farm Bureau of approximately \$2,000,000 for immediate improvements.
- 4) The Farm Bureau, in compliance with the Management Agreement, has increased the truck unloading capability from 12 to 25 trucks per hour and has increased the hopper car unloading rate from three to nearly six cars each hour. It also has added: (a) a new truck scale and a new rail scale, (b) an electronic bulk weighing system to the ship, and (c) has increased the size and speed of the grain elevator leg used to handle the grain from the grain pit to the top of the elevator. The Farm Bureau has also implemented major changes and improvements in handling grain for distribution to the various bins including hot-spot detection and indication equipment, automatic samplers, pneumatic ticket delivery system, sample delivery system, bin aeration systems, new elevator superintendent's office, truck inspection lab, ships' lab, inspection shed and has also completed paving of the 3.6 acre truck staging site. The Farm Bureau has spent in excess of \$1.5 million to date for these improvements to the state-owned facility. No contribution was made by the Ports Authority or the State of South Carolina toward these improvements.

- 5) The report also finds fault with the Farm Bureau's accumulation of earnings in recent years. In doing so, it refuses to consider the Farm Bureau's losses and bankruptcy in early years and, once again, reflects misunderstanding of the Agreement insofar as the ultimate financial responsibility of the Farm Bureau is concerned. The operation of this grain facility requires the operator to "buy long" and "sell short." This entails considerable risk in a volatile grain market. It would be inappropriate for the Ports Authority to risk the taxpayers' money in such an operation, and this position was supported by the 1971 Clemson-USC study. The Farm Bureau is willing to undertake the risk and should receive the gains or suffer the losses. Furthermore, the Farm Bureau will need the accumulated earnings to keep the facility at the state of the art and to provide funds for paying the farmers in advance of their resale of the grain. The Farm Bureau is an open association of South Carolina farmers whose membership represents more than 70,000 farm families in this State. It is a non-profit association. The announced policy of the Farm Bureau is to: use the revenues from this facility to rebuild adequate working capital; satisfy certificates of indebtedness; improve the elevator facilities; and refund to users (farmers) any funds not required for operations.

II. Questions and Answers

Five questions pertaining to the grain elevator operation have been posed to the Audit Council. Unfortunately, the report fails to answer all the questions and is often evasive, redundant and unstructured in its responses to others. It is worth noting that the specific questions were never posed to the Ports Authority. The questions should be answered as follows:

1) *Why does the South Carolina State Ports Authority lease the State's facility to South Carolina Farm Bureau Marketing Association, and, in turn, they sub-lease it to a Georgia corporation? Is the Farm Bureau a necessary party?*

The Ports Authority delegates control of the facility to the Farm Bureau as a necessary incident of the Management Agreement. The operator should have possession and control of the facility.

The Farm Bureau was selected because it has the capability of managing the facilities; it is a non-profit organization which represents 85 per cent of South Carolina farmers and is open to all; during an open bid period, it made a better offer, all things considered, than any other potential operator; and the General Assembly indicated its preference for this operator. The Ports Authority believed, and still does, that this public facility, built to promote agricultural exports, would be most appropriately managed by this group which has the long range interest of the South Carolina farmers in mind, in contrast to commercial operators whose primary concern is their own corporate profit.

The Questioner is apparently under the misapprehension that the management and operation of the facility is delegated to some other concern by the Farm Bureau. This is incorrect. The Farm Bureau has a storage and handling agreement with Cargill, a midwestern corporation. The agreement calls for the Farm Bureau to reserve space for the storage of Cargill's grain in return for that firm's commitment to buy and market most of the expected grain. Cargill also agrees to share its South Carolina profits with

the Farm Bureau. The management and operation of the grain elevator, however, remains the responsibility of the Farm Bureau. Cargill has no employees at the facility. The most important aspect of the Agreement is its guarantee of a market for South Carolina grains. This is certainly within the scope of the management responsibilities assigned to the Farm Bureau.

The selection of the Farm Bureau Marketing Association was a reasonable decision by the Ports Authority considering its purposes and aims, as well as legislative direction.

2) *Are and have the taxpayers of South Carolina subsidized the South Carolina Farm Bureau? If so, to what degree and what are the legalities of these arrangements?*

The operation of the grain facility was described by the 1971 Clemson-USC study as ". . . a highly productive subsidy to farm income with somewhat larger benefits accruing to the total economy. Considering the potentially large indirect benefits and the public ownership of the facility, future operations should continue to be subsidized so long as the facility can be kept in operation at little or no additional costs to the State."

The statutes and resolutions of the General Assembly demonstrate an intent and direction to subsidize the agricultural sector of this State.

If this facility were operated by the Ports Authority staff, all of the operating costs including wages, would be borne by the State. On the other hand, if this facility were operated by an outside commercial concern, such concern would require a profit. So, in either of the above cases, the State would bear some cost of that operation. This particular Agreement generates benefits sufficient to offset these costs, however, so that no subsidy exists. The report's claim that taxpayers have subsidized the Farm Bureau in the amount of \$2,506,865 simply does not address the reality of the situation (See the attached economic analyses).

The Ports Authority believes such Management Agreements are proper and legal devices for providing public facilities. Gilbert v. Bath, 267 S.C. 171, 227 S.E.2d 177 (1976); Bolt v. Cobb, 253 S.C. 408, 82 S.E.2d 789 (1954); and compare Harrison v. Day, 202 Va. 967, 121 S.E.2d 615 (1961). It is immaterial that the lessee receive some benefit.

The Farm Bureau now has an action pending in the South Carolina Supreme Court to remove the cloud created by the Attorney General's opinion, which questions the validity of the Management Agreement.

3) *Are South Carolina farmers losing as a result of the present use of this facility?*

The answer to this is no! A 1974 study by the University of South Carolina entitled "Impact of the State Ports Authority upon the Economy of South Carolina," states that South Carolina in 1970 exported a higher percentage of its agricultural produce, in terms of value, than any other state in the nation. This was attributed primarily to the existence of the grain elevator. A 1977 update of this same study demonstrated a 236%

increase in grain exports from 1973 to 1977, again primarily associated with the grain elevator.

The creation of new markets has encouraged additional crops, which have resulted in higher gross yields and increased income for farmers. Other benefits may be found in the answer to question five and the report's analysis of grain prices.

The report's claim that success of the elevator cannot be attributed to the presence of the Farm Bureau as operator is not supported and, on its face, should be subject to question by any reasonable person.

4) *Is this arrangement limiting shipment of South Carolina grains from the Charleston Port? Might it not be advantageous to the farmers of this State if they were to have priority use of this facility?*

The answer to these questions is also no! The shipment of grains has steadily increased, limited only by the relative success of each year's harvest. There is no information that would suggest the present management has restricted or prevented shipment of South Carolina grains or that South Carolina farmers are being squeezed out by grains from other states. The very presence of the Farm Bureau is designed to preclude such action. The Ports Authority has never received a single complaint from a South Carolina farmer in connection with the operation of the grain elevator. There are, not incidentally, benefits resulting from the handling of out-of-state grains. Additional volume fosters greater efficiency, lowers operating costs and bolsters prices paid to farmers for their grains. The Ports Authority, therefore, sees no reason to impose a priority. Accordingly, the legal question as to whether a public facility may establish priorities based on geographical location need not be addressed.

5) *Are South Carolina taxpayers and farmers reaping the maximum benefit from the present use of this facility?*

The Council's own report reveals the State has received indirect benefits of approximately sixteen million dollars from the operation of the grain elevator from 1962 through 1980, and states that 1980 cash receipts of the elevator amounted to 26.4 per cent of the value of South Carolina's farm production.

The 1971 Clemson-USC report addressed economic benefits to the State from operation of the grain elevator as an export facility. The Clemson-USC report said that increases in the prices received for grains after the grain elevator began operation were attributed in part to the operation of the elevator as an export facility and further stated that estimated impact on the State's total economy from the elevator from 1962 through 1970 was 9.2 million dollars, including increases in farm income and the multiplier effects of increased farm income.

The Clemson-USC report estimated that the combined effects of increased income to grain producers, and the second round multiplier effects of increased farm

income would result in a total impact to the State's economy of approximately seven million dollars from 1971 through 1980. The Council's staff contacted Clemson University officials, and they stated that the operation of the grain elevator has produced indirect benefits to farm income in the State's economy as a whole as projected in 1971.

Council's report does not answer question five as to the maximization of benefits. Maximization is an abstract and idealistic term; nevertheless, it can be said with certainty that farmers and taxpayers are enjoying broad and substantial benefits from this operation. The Council report itself concludes that the operation of the grain elevator as an export facility appears to have a positive impact on the economy of the State.

II. Council's Recommendations

Recommendation 1 is that the Attorney General initiate an action to determine the constitutionality of the Management Agreement. An action is already pending in the South Carolina Supreme Court that should resolve any legal question as to the validity of the Management Agreement.

The report asserts that the depreciation expense for the grain elevator was rescheduled by the Ports Authority in order to reduce the rental payment to be made by the Farm Bureau, and further asserts that the Ports Authority was unmindful of the State's interest expense when it negotiated the 1977 Agreement. Both of these assertions are without foundation.

The move from the earlier management agreement to the 1977 Management Agreement presented significant accounting questions to the Authority. After all, the Farm Bureau was taking over the entire repair and maintenance for the elevator, had agreed to invest two million dollars to improve the throughput capacity of the elevator, and had agreed to keep the elevator up to the state of the art of grain handling. The impact of these negotiated terms clearly demanded some kind of accounting recognition.

Four methods to recognize these substantial benefits were available: footnoting the financial statements of the Authority; a recognition of revenue; an entry to the contributed capital accounts; or rescheduling the depreciation expense to attempt to more accurately reflect service life in view of the Agreement. The first method seemed insufficient and the next two seemed to not be conservative. The fourth possible method was chosen because it struck a balance between the too conservative and the too liberal in recognizing a substantial benefit by depreciating the consolidated unamortized costs of the concrete and the equipment of the structure over a longer period of time. Eighty-five per cent (85%) of the elevator is concrete and lasts for exceedingly long periods of time. The equipment of the structure was to be repaired and maintained, brought to the state of the art, and kept at the state of the art with no financial burden to the Authority. (The report cites depreciation schedules for grain elevators of shorter length than the one in

use by the Ports Authority. A mere comparison of these other schedules to the Authority's schedule is meaningless without questioning whether such other elevator schedules have shorter lives for tax purposes, and without considering the substantial burdens removed from the Ports Authority. Also, a similar elevator in Galveston is being depreciated on a ninety year schedule.)

As to the interest expense being borne by the State, the Authority did in fact consider that in its deliberations on the renegotiation in 1977. The Authority believed then and believes now that the full benefits to the State's economy from its supervision and the Farm Bureau's operation of the grain elevator far out distance the costs to the State, considering all costs and both indirect and direct benefits.

The Council claims the Authority has negotiated a Management Agreement which "does not allow changes to be made as economic and operational conditions have changed." This is simply incorrect. As a matter of fact, the Authority has previously pointed out to the Audit Council that the provisions of the Agreement call upon the Farm Bureau to maintain the facility in state of art condition (as apparently supported by the Attorney General's opinion of October 21, 1981). Every expenditure made during the life of the Agreement will obviously be made at the then existing currency values. The Authority submits such a requirement adequately provides for "changes in economic and operational conditions."

Recommendation 2 calls upon the Authority to annually review the operations of the grain elevator, approve a certified public accountant selected by the Farm Bureau to conduct an audit and submit a report to the Budget and Control Board and the General Assembly in compliance with Section 8 of Act 1272 of 1970.

The Ports Authority did not require financial audits from the Farm Bureau after the 1970 Act because the act eliminated the provisions which required application of the revenues (then the per-bushel fee) from this facility toward payment of bonds and interest. That action was a clear indication to the Ports Authority that it was no longer required to attempt to liquidate the bonds. The Budget and Control Board neither asked for such audits nor determined or directed that any revenue from the elevator operations be applied to pay principal or interest on these bonds, and the State Auditor, in his annual audits of the Authority, never raised this question. These actions seem to indicate a consensus that the audits were no longer necessary.

The Ports Authority has monitored the operation of the facility and finds that it has in fact been efficient and has benefited the State and its farmers.

Since a request for the audits was received from the Audit Council, the Authority has proceeded to collect the audits.

Recommendation 3 calls upon the Ports Authority to develop criteria for annual joint inspections of the grain elevator. The report claims that the Authority has been

negligent in inspections of the grain elevator facility and has not supervised the improvements required by the 1977 Management Agreement. The grain elevator is a part of the Authority's North Charleston Terminal operating under a management agreement, and is not an isolated facility removed from the continuous view of Authority personnel. Also, the Authority carries property and casualty insurance on the elevator and the insurance carrier's underwriters perform periodic inspections of the facility.

The Ports Authority has criteria for inspecting the elevator which are now being formally written. These inspections are and will continue to be jointly conducted by representatives of both the management services division of the Ports Authority and the Farm Bureau.

Recommendation 4 would require the Ports Authority to develop a complete inventory description, listing all improvements to the elevator, and tag all equipment. The grain elevator at the Ports Authority's North Charleston Terminal is a system for unloading grain from rail cars and trucks; sampling and inspecting; moving; storing; and loading grain onto vessels. It is an integrated grain handling system and cannot function without its components. Title to the total elevator facility and the improvements made (and those which will later be made) is in the Ports Authority. Since the grain elevator does not consist of individual items which are subject to secret misappropriation without affecting the system, the Authority does not consider it necessary or practical to undertake to "tag" the massive components of this facility. Furthermore, the report's concern that tagging would preclude disagreement between the Authority and the Farm Bureau is without foundation - there can be no such disagreement since the Authority owns the entire facility. Nevertheless, the Authority will examine the merit of selective identification notices as to the Authority's ownership.

As to approval of improvements, the report is simply incorrect in its contention that the improvements called for in the 1977 Management Agreement were not approved by the Ports Authority. Much consideration was given to the improvements called for, both by the staff and the Authority Board. The Ports Authority will also specifically review and approve, in writing, plans for future improvements.

APPENDIX L (CONTINUED)
SOUTH CAROLINA STATE PORTS AUTHORITY
ECONOMIC ANALYSIS OF 1977 MANAGEMENT AGREEMENT
(Based on Comparison of 1977 Agreement to Previous Agreement)
1962-1998

	<u>1962-1980</u>	<u>1981-1983</u>	<u>1984-1998</u>	<u>1962-1998</u>
<u>Operating Revenues:</u>				
Dockage Fee	\$ 297,424	\$ -0-	\$ -0-	\$ 297,424
Share of Profits	24,788	-0-	-0-	24,788
Per Bushel Fee	595,303	-0-	-0-	595,303
Rental of Property	334,309	232,057	1,160,283	1,726,649
Miscellaneous	167,742	-0-	-0-	167,742
<u>Contractual Benefits:</u>				
Equipment and Improvements (1)		2,000,000	4,100,000	6,100,000
Absorption of Repairs and Maintenance Expense (2)		42,674	437,419	480,093
	<u>\$ 1,419,566</u>	<u>\$2,274,731</u>	<u>\$5,697,702</u>	<u>\$9,391,999</u>
<u>Operating Expenses:</u>				
Insurance	99,825	21,000	112,500	233,325
Outside Services	1,371	-0-	-0-	1,371
Repairs and Maintenance	199,848	-0-	-0-	199,848
Depreciation (3)	2,171,656	189,363	765,000	3,126,019
Total Operating Expenses	<u>\$ 2,472,700</u>	<u>\$ 210,363</u>	<u>\$ 877,500</u>	<u>\$3,560,563</u>
<u>Operating Income:</u>	<u>\$ (1,053,134)</u>	<u>\$2,064,368</u>	<u>\$4,820,202</u>	<u>\$5,831,436</u>
<u>Non-Operating Expenses</u>				
Interest (4)	1,453,731	66,750	25,500	1,545,981
Gross Gain (Loss) (5)	<u>\$ (2,506,865)</u>	<u>\$1,997,618</u>	<u>\$4,794,702</u>	<u>\$4,285,455</u>

(1)The grain elevator was completed in 1962. The original cost included approximately \$1,300,000 of equipment. In 1977, the bulk of this equipment needed to be either replaced or improved. The cost of such improvements was set at \$2,000,000, of which \$1,500,000 has been completed. The contract provides that all of the improvements be completed by 1983. In view of this experience, it is reasonable to project that a similar expenditure will have to be made in the period 1984-1998 (15 years). Based on an average annual inflation rate of 7 percent, the improvements are expected to cost \$4,100,000. Under the 1977 Management Agreement, the Farm Bureau Marketing Association must pay for these improvements. The Authority has, therefore, been relieved of this cost, a saving over the prior contractual arrangements. Such savings are, therefore, reflected in the above analysis.

(2)The State Ports Authority expended \$199,848 on repairs and maintenance during the period 1962-1984. Under the 1977 Management Agreement, the Farm Bureau Marketing Association must pay for all repairs and maintenance. The Authority has, therefore, been relieved of this cost, a saving over the prior contractual arrangements. Such savings are, therefore reflected in the above analysis. (The amounts shown for the periods 1981-1983 and 1984-1998 are based on past expense, plus an average annual rate of inflation of 7 percent.)

(3)The write-off of the unamortized cost of the grain elevator was rescheduled in fiscal year 1978 to effect, in 71 years, a net book value of zero. The basis for the decision to use 71 years is to be found in the significant new obligations of the S.C. Farm Bureau Marketing Association in the 3/1/77 Management Agreement. Those new obligations consist of: 1) the Association bearing the total cost of repairs and maintenance; 2) the Association expending approximately \$2 million to improve the capabilities and throughput capacity of the elevator; and 3) the Association also making throughout the term such improvements and adaptations as are necessary to keep the equipment suitable for use in the then current trade of handling, lading, discharging, and storing grain. Those new obligations meant that the Authority, after the 21 years of the Agreement, would have a technologically sound elevator in good repair, such that the then remaining unamortized cost would reasonably be written-off over the next 50 years. This rescheduling was researched in accounting literature and discussed with the Authority's independent auditors, who accepted such concepts.

(4)The interest shown for the period 1962-1980 is the same interest figure shown in Table 2 of the draft report. Table 2 reflects interest beginning with the year 1957, whereas construction of the grain elevator was not started until 1960. A more precise examination would reveal that the interest should be \$34,271 less than the amount shown. However, the figure shown in the draft report was used for the ease of comparison.

(5) a. The unamortized historical cost of the grain elevator at June 30, 1998, will be \$2,414,503. However, the estimated value of the grain elevator at that time should be between \$10 and \$15 million in view of the contract provisions as set forth in Note 3.

b. In the period 1984-1998, Equipment Replacement and Improvements of \$4,100,000 and Repairs and Maintenance of \$437,419 includes an average annual rate of 7 percent for inflation.

APPENDIX L (CONTINUED)

SOUTH CAROLINA STATE PORTS AUTHORITY ALTERNATE ECONOMIC ANALYSIS OF 1977 MANAGEMENT AGREEMENT (Based on Comparison of 1977 Agreement to Previous Agreement. Modified* to Reflect Results of the Arguments of the Legislative Audit Council) 1962-1998

	<u>1962-1980</u>	<u>1981-1983</u>	<u>1984-1998</u>	<u>1962-1998</u>
<u>Operating Revenues:</u>				
Dockage Fee	\$ 297,424	\$ -0-	\$ -0-	\$ 297,424
Share of Profits	24,788	-0-	-0-	24,788
Per Bushel Fee	595,303	-0-	-0-	595,303
Rental of Property	334,309	232,057	1,160,283	1,726,649
Miscellaneous	167,742	-0-	-0-	167,742
<u>Contractual Benefits:</u>				
Equipment and Improvements (1)		2,000,000	3,350,528	5,350,528
* "Write-off" of 81-83				
Improvements (2)			(-2,000,000)	(-2,000,000)
	<u>\$ 1,419,566</u>	<u>\$2,232,057</u>	<u>\$ 2,510,811</u>	<u>\$ 6,162,434</u>
<u>Operating Expenses:</u>				
Insurance	99,825	21,000	112,500	233,325
Outside Services	1,371	-0-	-0-	1,371
Repairs and Maintenance	199,848	-0-	-0-	199,848
* Depreciation (3)	<u>2,446,321</u>	<u>404,037</u>	<u>1,335,208</u>	<u>4,185,566</u>
Total Operating Expenses	<u>\$ 2,747,365</u>	<u>\$ 425,037</u>	<u>\$ 1,447,708</u>	<u>\$ 4,620,110</u>
<u>Operating Income:</u>	<u>(1,327,799)</u>	<u>1,807,020</u>	<u>1,063,103</u>	<u>1,542,324</u>
<u>Non-Operating Expenses</u>				
Interest (4)	<u>1,419,460</u>	<u>66,750</u>	<u>25,500</u>	<u>1,511,710</u>
Gross Gain (Loss)	<u><u>\$ (2,747,259)</u></u>	<u><u>\$1,740,270</u></u>	<u><u>\$ 1,037,603</u></u>	<u><u>\$ 30,614</u></u>

(1)The grain elevator was completed in 1962. The original cost included approximately \$1,300,000 of equipment. In 1977, the bulk of this equipment needed to be either replaced or improved. The cost of such improvements was set at \$2,000,000, of which \$1,500,000 has been completed. The contract provides that all of the improvements be completed by 1983. In view of this experience, it is reasonable to project that a similar expenditure will have to be made in the period 1984-1998 (15 years). Based on an average annual inflation rate of 7 percent, those improvements are expected to cost \$3,350,528.

Under the 1977 Management Agreement, the Farm Bureau Marketing Association must also pay for these improvements. The Authority has, therefore, been relieved of this cost, a saving over the prior contractual arrangements. Such savings are, therefore, reflected in the above analysis.

(2)This amount represents the equivalent of amortization of the \$2,000,000 put into equipment and improvements by the Farm Bureau Marketing Association during the period ending 1983.

(3)This is the depreciation expense as originally scheduled, reflecting what the expense would have been if no rescheduling had been done in 1978.

(4)The interest shown for the period 1962-1980 is slightly different from the interest figure shown in Table 2 of the draft report. Table 2 reflects interest beginning with the year 1957, whereas construction of the grain elevator was not started until 1960. A more precise examination would reveal that the interest should be \$34,271 less than the amount shown in Table 2.